

EXAMINING TREASURY MARKET FRAGILITIES AND PREVENTATIVE SOLUTIONS

HEARING

BEFORE THE

TASK FORCE ON MONETARY POLICY, TREASURY
MARKET RESILIENCE, AND ECONOMIC PROSPERITY

OF THE

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Thursday, May 15, 2025

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EXAMINING TREASURY MARKET FRAGILITIES AND PREVENTATIVE SOLUTIONS

Thursday, May 15, 2025

U.S. HOUSE OF REPRESENTATIVES,
TASK FORCE ON MONETARY POLICY,
TREASURY MARKET RESILIENCE, AND
ECONOMIC PROSPERITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The Task Force met, pursuant to notice, at 10:02 a.m., 2128 Rayburn House Office Building, Hon. Frank Lucas [Chairman of the Task Force] presiding.

Present: Representatives Lucas, Hill, Huizenga, Barr, Stutzman, Fitzgerald, Flood, De La Cruz, Downing, Vargas, Sherman, Casten, and Bynum.

Chairman LUCAS. The Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity will come to order. Without objection, the chair is authorized to declare a recess of the committee at any time.

Without objection, all members will have 5 legislative days within which to submit extemporaneous material to the chair for inclusion in the record.

I would now like to recognize myself for 4 minutes for an opening statement.

OPENING STATEMENT OF HON. FRANK D. LUCAS, CHAIRMAN OF THE TASK FORCE ON MONETARY POLICY, TREASURY MARKET RESILIENCE, AND ECONOMIC PROSPERITY, A U.S. REPRESENTATIVE FROM OKLAHOMA

This hearing is entitled “Examining Treasury Market Fragilities and Preventative Solutions.” Today, we will take a 30,000-foot view of Treasury market structure with a particular focus on the market under stress. We will endeavor to use last month’s volatility as a case study in current market conditions and functioning and examine what changes may have been helpful in improving the resilience of the market. We cannot overstate the importance of this topic. A highly liquid and resilient Treasury market is fundamental to the global economy.

There have been a number of episodes in recent years that have made us remember the enormous privilege we have of being the world’s global reserve currency and boast safe haven asset status. Last month was one of those moments. We observed almost every measure of liquidity in the Treasury market decline rapidly over a 3-day period.

Thankfully, the market is resilient and recovered quickly from the stress of the broader macroeconomic uncertainty but challenges like last month remind us that we must safeguard our most important asset, our deep, liquid, healthy, sovereign debt market. We can bolster the resilience of the market by learning lessons from market stress we observed in 2014, 2019, 2020, and a few weeks ago. My, it seems relevant, does not it, when you think about that?

For example, in 2023, the Securities Exchange Commission (SEC) voted to mandate central clearing for cash transactions and repurchase agreements involving Treasurys. This is a fundamental shift and a massive undertaking by market participants. I have been working with the SEC to ensure that firms have appropriate time to come into compliance. Similarly, we need to get implementation right. There are outstanding questions that need to be addressed, and Chairman Atkins is well-positioned with broad stakeholder feedback to clarify the rule's execution.

I have also repeatedly urged the prudential regulators to exempt Treasurys and reserves from the supplemental leverage ratio and the enhanced supplemental leverage ratio due to their low-risk nature. We should incentivize participation in the market, not make it cost prohibitive.

The Treasury market has doubled in size since I was on the Dodd-Frank Conference Committee. We should reconsider some of the provisions enacted that may have had adverse consequences and that disincentivize participation in financing our debt. In the last decade, we have seen dramatic changes in buyers of Treasurys. Some of this is positive. Innovation is driving demand. On the other hand, we should look carefully at what is causing some investors to leave the market. Our debt instruments need to retain their attractiveness to a broad array of participants.

I want to make it clear, there is no silver bullet here. The Treasury market will always be sensitive to macroeconomic challenges, but there are changes we can consider to improve this resilience. I hope to work with my colleagues on both sides of the aisle to address these constraints.

With that, I yield back.

The chair now recognizes the ranking member of the subcommittee, Mr. Vargas, for 4 minutes for an opening statement.

OPENING STATEMENT OF HON. JUAN VARGAS, RANKING MEMBER OF THE TASK FORCE ON MONETARY POLICY, TREASURY MARKET RESILIENCE, AND ECONOMIC PROSPERITY, A U.S. REPRESENTATIVE FROM CALIFORNIA

Mr. VARGAS. Thank you very much, Mr. Chairman, and thank you for forming such an excellent panel and I want to thank the witnesses for being here today. Thank you to each and every one of you.

A resilient and liquid Treasury market is critical not only to the functioning of our own capital markets but also to the functioning of markets around the world. The Treasury market plays a key role in the Federal Reserve System (Fed) implementing its monetary policy, provides the benchmark risk-free rate for pricing other assets, and finances our government at a low cost to the taxpayers.

Last month, when the Treasury market experienced volatility in the wake of President Trump's liberation date, it was no surprise that many expressed alarm about the financial consequences surrounding the tariffs. We saw the 10-year yield jump more than 50 basis points, which represented the largest 3-day jump since 2001.

As this administration continues to publish policy edicts through Truth Social, a number of analysts have signaled concern that the market volatility is here to stay. Even though we did see relatively strong demand in the Treasury's auctions of 10-year and 30-year bonds following the initial movement in the market, all this uncertainty makes maintaining resiliency all the more important.

Growing uncertainty is not the only reason it is pivotal to shore up the strength of our Treasury market. The growth in existing Treasury market debt has brought new attention to the issue of resilience, and this growth is on track to continue. In fact, the non-partisan Congressional Budget Office has predicted that the U.S.' national debt held by the public over the next 10 years will grow from \$30 trillion to \$52 trillion, incredible numbers.

They also found that extending President Trump's tax cut for the next 10 years would add \$4.6 trillion to our national debt. Let us not forget that for all the talk about my colleagues on the other side of the aisle about the need for government efficiency and fiscal conservatism, the last President to balance a budget and produce a surplus was a Democrat, President Bill Clinton. As the government issues more debt, it will need investors willing to buy it and it is important that dealers continue to have the ability to buy and sell this new debt. So in order to have a strong Treasury market, we also need to evaluate whether dealers maintain the capacity they need to intermediate.

Given all these challenges, it is critical that we keep taking steps toward improving the resiliency of the Treasury market. That is one of the reasons why I have been glad to see that our financial regulators have undertaken several reforms aimed just at that. For instance, I am hopeful that the final rule requiring the central clearing of eligible transactions will, as former SEC Chair Gensler said, "Help to make the Treasury market more efficient, competitive, and resilient." In order for that to happen, though, it is essential that the market participants and regulators continue to work together to implement it.

We have also seen steady progress on the increased data, transparency, and availability within the Treasury market. Financial Industry Regulatory Authority's (FINRA's) decision to move from publishing weekly aggregate volume transaction data to publishing daily aggregate volume transaction data was a step in the right direction. I look forward to continue to explore other ways to ensure that our Treasury market remains resilient for the foreseeable future.

With that, Mr. Chairman, I again thank you, and I yield back.

Chairman LUCAS. I thank the gentleman, and I appreciate his compliment about my being in the majority for that 3 1/2 years of surplus. With that, the chair now recognizes the gentleman from the full committee, Chairman Hill, for 1 minute.

STATEMENT OF HON. FRENCH HILL, CHAIRMAN OF THE COMMITTEE ON FINANCIAL SERVICES, A U.S. REPRESENTATIVE FROM ARKANSAS

Chairman HILL. Thank you, Chairman Lucas.

Today's hearing will explore the recent volatility in the Treasury markets and potential regulatory changes to mitigate future risk and ensure liquidity. While we all witnessed the disruption in the Treasury market last month, the bond market can sometimes react sharply to sudden policy changes, irrespective of whether those policies come from former President Obama, former President and current President Trump, or even the Fed itself.

The Treasury market is the world's largest and most liquid government bond market, and given its global and domestic importance, it is paramount that it remains resilient as possible during times of volatility. In all markets, volatility is probable and inevitable, and thus policymakers must push for policies that ensure that the markets remain liquid and orderly with the goal of preventing or mitigating future episodes of volatility.

I look forward to these excellent panelists' views on recent Treasury market events and continue our policy conversation to ensure our U.S. Treasury market resiliency.

Thank you, Mr. Chairman. I yield back.

Chairman LUCAS. Thank you, Mr. Chairman.

Today, we welcome the testimony of Mr. Nathaniel Wuerffel, Head of Product, Global Collateral, and Head of Market Structure at Bank of New York (BNY); Dr. Darrell Duffie, Adams Distinguished Professor of Management and Professor of Finance, Graduate School of Business and Professor by Courtesy, Department of Economics, Stanford University; Mr. Ira Jersey, Chief U.S. Interest Rate Strategist and Global Rates Team Leader, Bloomberg Intelligence; Ms. Jill Cetina, Executive Professor of Finance, Mays Business School, Texas A&M University.

We want to thank each of you for taking time to be here, and each of you will be recognized for 5 minutes to give an oral presentation of your testimony. Without objection, your written statements will be made a part of the record.

Mr. Wuerffel, you are now recognized for 5 minutes.

STATEMENT OF MR. NATHANIEL WUERFFEL, HEAD OF PRODUCT AND GLOBAL MARKET STRUCTURE, BANK OF NEW YORK

Mr. WUERFFEL. Good morning, Chairman Lucas, Ranking Member Vargas, and members of the Task Force. Thank you for the opportunity to testify on the importance of U.S. Treasury market resilience. My name is Nate Wuerffel, and I am the head of market structure and the head of product for the Global Collateral Platform, which supports financing of Treasury securities at BNY.

Prior to joining BNY, I spent 25 years at the Federal Reserve. In my last role, I ran the Domestic Markets Trading Desk, carrying out large-scale trading operations, intelligence gathering, and financial market analysis for the Federal Open Market Committee and the U.S. Treasury Department, among other stakeholders.

BNY was founded by Alexander Hamilton 240 years ago and has a long and interconnected history with the U.S. Treasury market

ever since. We have become a global financial services company that helps make money work for the world by managing it, moving it, and keeping it safe. Our founder negotiated the first loan to the U.S. Government from the Bank of New York. Shortly thereafter, as the first Treasury Secretary, he laid out his vision for how the country would address the Nation's debt.

It was rooted in two core attributes, safety and liquidity. Government bonds would be safe because they would be backed in full by the U.S. Government on their original terms and liquid because they would be easily converted to cash at a fair market price by any holder. It proved to be a resounding success. We are proud of the role we continue to play supporting the U.S. Treasury market, including as the primary settlement provider, among other activities.

The Treasury market plays an important role in the lives of everyday Americans. It serves as a benchmark for borrowing rates for everything from mortgages to auto and consumer loans. At \$29 trillion outstanding, the Treasury market has grown. Over the last decade, the market has experienced several episodes of dysfunction, including in 2014, 2019, and following the coronavirus disease (COVID-19) pandemic.

Most recently, the events that took place in April tested market functioning. They prompted investors to question the resilience of the market in the face of policy uncertainty and the potential impact on the future direction of growth, inflation, interest rates, and the supply of Treasury debt. The events serve as a reminder that the safety and liquidity of the Treasury market are essential to its continued functioning.

Given the critical role of the Treasury market, over the last decade, both the public and the private sectors have stepped up work to improve the resilience of the market. One of the most consequential of these efforts is the SEC's central clearing rule, which should enhance financial stability by improving the willingness of market participants to continue trading in the Treasury market, even in times of stress. The Treasury clearing rule is only one of several public and private sector solutions that are important to strengthen the safety and liquidity of the Treasury market.

I would highlight three priorities. First, timely completion of the central clearing rule would reduce counterparty credit risk and improve financial stability. Implementation should provide a level playing field for all market participants, be limited to Treasury security transactions and not inadvertently capture non-Treasury trades, continue the current industry and regulatory momentum to promote smooth implementation, and avoid delays that lead to excessive transition costs, and result in consistent margin practices across the ecosystem.

Second, a targeted adjustment to leverage ratios for cash and Treasury securities can support the ability of banks to hold cash reserves and intermediate in the Treasury market. The leverage ratio was intended to be a backstop but today constrains banks from supporting Treasury market intermediation, particularly in times of stress. A narrow adjustment would be a more effective means of supporting Treasury market intermediation than alter-

natives such as lowering the overall ratio, which might result in increased activity and riskier assets.

Third, faster, more reliable and more efficient ways to exchange Treasury securities for cash are essential to support market liquidity. This includes discount window modernization, making it easier to move Treasury securities across public and private liquidity pools, and options for early and intraday repo.

BNY commends the committee for its work examining the resilience of the Treasury market, and we look forward to working with you to support a safe and liquid Treasury market. I am happy to answer any questions you may have.

[Prepared statement of Mr. Wuerffel follows:]



Statement of Nathaniel Wuerffel
Head of Product for the Global Collateral Platform and Head of Market Structure
BNY
Before the
United States House Financial Services Committee
Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity
"Examining Treasury Market Fragilities and Preventative Solutions"
May 15, 2025

I. Introduction

Good morning, Chairman Lucas, Ranking Member Vargas, and members of the Task Force. Thank you for the opportunity to testify on the importance of U.S. Treasury market resilience. My name is Nate Wuerffel, and I serve as BNY's Head of Product for the Global Collateral Platform and Head of Market Structure.

BNY is a global financial services company that helps make money work for the world—managing it, moving it, and keeping it safe. For more than 240 years BNY has partnered alongside clients, putting its expertise and platforms to work to help clients achieve their ambitions. Today, BNY helps over 90 percent of Fortune 100 companies and nearly all of the top 100 banks globally to access the money they need.¹ BNY supports governments in funding local projects and works with over 90 percent of the top 100 pension plans to safeguard investments for millions of individuals. As of March 31, 2025, BNY oversees \$53.1 trillion in assets under custody and/or administration and \$2.0 trillion in assets under management.²

II. Our History

BNY is the nation's oldest bank, founded by Alexander Hamilton in 1784.³ BNY established its credibility as a financial institution by being liquid, transparent, and highly resilient. These tenets, which have guided our growth as an institution, remain core to our business today.

¹ BNY. (n.d.). About BNY. Retrieved from <https://www.bny.com/corporate/global/en/about-us/about-bny.html>

² BNY. (2025, April 11). Earnings press release 1Q 2025. Retrieved from <https://www.bny.com/assets/corporate/documents/pdf/investor-relations/earnings/earnings-press-release-1q-2025.pdf>

³ Alexander Rose (n.d.). Making Money Work for the World: A Brief History of Bank of New York Mellon, <https://www.bny.com/assets/wealth/pdf-library/240-history-timeline.pdf>

Over our 241-year history, we have developed solutions that led to a number of firsts in the United States economy: we provided the first loan to the U.S. government after the Revolutionary War; we were the first company listed on the New York Stock Exchange; and we provided essential financing to major infrastructure projects, from the Louisiana Purchase to the Erie Canal and from the transnational railroads to the New York City Subway system. BNY was also one of the first financial institutions to use an electronic system for clearing government securities. Those actions – taken for granted today – were financial innovations at the time and have played a significant role in helping the U.S. become the world's predominant economic engine.

We are proud of the historic role that BNY has had in helping to grow the U.S. financial system into the leading power it is today.

III. Our Business Today

Today, we are a global financial services company with offices in more than 35 countries.⁴ Our business strategy is led by client choice. We are where our clients want to be, and we have the scale and capacity to support their goals across the investments, communities, and countries they want to be in. Our global client base ranges from financial services firms, pension funds, mutual funds, unions, endowments, corporations, as well as federal, state, and local governments. We are proud of the trust our clients place in us, and of our role in helping them achieve their financial objectives, no matter their size, scale, or complexity.

We have a different business model compared to a traditional retail, commercial, or investment bank. Our core business is to provide custody, clearing, collateral management, and other financial services to institutions and governments—not consumer banking.

Through its three primary business segments, BNY is uniquely positioned to serve the end-to-end investment lifecycle, acting as a single, integrated platform for clients looking to create, administer, manage, transact, distribute, or optimize investments.⁵

Our Securities Services segment is composed of our Asset Servicing, Corporate Trust, and Depositary Receipts businesses. This segment includes our core custody services: the safekeeping, recordkeeping, and servicing of assets on behalf of our clients and their clients.

Our Market and Wealth Services segment includes a number of industry-leading businesses. The first is Pershing, whose platform provides access to clearing, settlement, and other services for broker dealers and registered investment advisors. Our Treasury Services business includes our payments platform, which offers clients the ability to process

⁴ BNY. (n.d.). Retrieved from <https://www.bny.com/corporate/global/en/about-us/locations.html>

⁵ BNY. (2025). Annual Report 2024, Retrieved from <https://www.bny.com/assets/corporate/documents/pdf/investor-relations/annual-report-2024.pdf>

payments across multiple instant payment rails. We process approximately \$2.4 trillion of payments per day across all payment rails.⁶ Through our Clearance and Collateral Management businesses, we clear and settle more than \$19 trillion in equity and fixed-income transactions daily in over 90 markets and manage more than \$6.5 trillion in collateral balances worldwide.^{7,8}

Finally, our Investment and Wealth Management segment comprises our asset management business and a private bank that services individuals, families, family offices, and non-profits. BNY has a multi-firm investment management business, which gives clients the choice to invest in an array of asset classes and strategies through a variety of vehicles depending on their needs.

IV. History of the U.S. Treasury Market

The U.S. Treasury Market and BNY share a long and interconnected history. Following the Revolutionary War, the U.S. owed \$80 million with unpaid interest on the debt amounting to \$4.5 million annually. In 1787, the government stopped submitting installments even on the principal.⁹ After being named our nation's first Treasury secretary, Alexander Hamilton negotiated a \$200,000 loan from The Bank of New York to fund the government and meet the country's immediate obligations.¹⁰ That loan – known as Warrant #1, which sits proudly in our New York headquarters – was just the beginning.

In January 1790, Hamilton sent a report to Congress that laid out his vision for how the country would address the nation's debt.¹¹ He believed that "[N]ational debt if it is not excessive will be to us a national blessing; it will be [powerful] cement of our union."¹² His plan was rooted in two core attributes: safety and liquidity. Government bonds would be safe because they would be backed in full by the U.S. government on their original terms, and liquid because they could be easily converted to cash at a fair market price by any holder.

⁶ BNY. (2025). Annual Report 2024. Retrieved from <https://www.bny.com/assets/corporate/documents/pdf/investor-relations/annual-report-2024.pdf>

⁷ BNY. (n.d.). Outsourced clearing fact sheet. Retrieved from <https://www.bny.com/assets/corporate/documents/pdf/solutions/outsourced-clearing-fact-sheet.pdf>

⁸ BNY. (n.d.). Clearing and Collateral Management. Retrieved from <https://www.bny.com/corporate/global/en/solutions/securities-services/clearance-and-collateral-management.html>

⁹ Alexander Rose (n.d.). Making Money Work for the World: A Brief History of Bank of New York Mellon, <https://www.bny.com/assets/wealth/pdf-library/240-history-timeline.pdf>

¹⁰ Id.

¹¹ National Archives. (n.d.). Report Relative to a Provision for the Support of Public Credit [9 January 1790]. Retrieved from <https://founders.archives.gov/documents/Hamilton/01-06-02-0076-0002-0001>

¹² National Archives. (n.d.). Letter from Alexander Hamilton to Robert Morris, [30 April 1781]. Retrieved from <https://founders.archives.gov/documents/Hamilton/01-02-02-1167>

Hamilton's plan proved to be a resounding success. Just five years later, the national debt was consolidated and interest payments paid on time. Overseas opinion of America's financial integrity was transformed. The United States enjoyed the highest credit rating in European capital markets and investors were so eager to buy U.S. bonds that they were selling for ten percent over par.¹³

Today, there is no other market in the world where so much liquidity can safely change hands so quickly. An average of more than \$926 billion in cash and \$5 trillion in financing transactions involving Treasury securities occur every day.¹⁴

V. Our Support of the U.S. Treasury Markets

Since issuing the first loan to the U.S., BNY has played an important role in building the safety and liquidity of the Treasury market:

- We are the primary settlement provider for the Treasury market.
- We custody approximately a third of marketable Treasury securities.
- We are the leading triparty liquidity venue in the world for Treasury securities.
- We are one of the top intermediaries in centrally cleared Treasury repo financing, and the world's leading agent lender.

VI. Role of the U.S. Treasury Markets in Americans' Lives

Owing to the United States' creditworthiness and status as the world's leading economy, the U.S. Treasury market has become the biggest, deepest, most liquid bond market in the world. It plays an important role in the lives of Americans.

- **It serves as a benchmark for global financial instruments and markets.** U.S. Treasury yields influence the borrowing rates for everything from mortgages to auto and consumer loans to corporate debt to capital markets globally.
- **It efficiently finances the U.S. government.** Through the "regular and predictable" issuance of debt with various maturities (short-term bills, medium-term notes, and long-term bonds), the Treasury market allows the government to be financed at the least cost to taxpayers over time.¹⁵

¹³ Alexander Rose (n.d.). Making Money Work for the World: A Brief History of Bank of New York Mellon, <https://www.bny.com/assets/wealth/pdf-library/240-history-timeline.pdf>

¹⁴ U.S. Department of the Treasury. (2025). Treasury Borrowing Advisory Committee, Developments in Central Clearing in the U.S. Treasury Market. Retrieved from <https://home.treasury.gov/system/files/221/TBACCharge2Q12025.pdf>

¹⁵ U.S. Department of the Treasury. (2024, July 11). Remarks by Assistant Secretary for Financial Markets Joshua Frost on Principles of U.S. Debt Management Policy. Retrieved from <https://home.treasury.gov/news/press-releases/jy2460>

- **It is used as a transmission mechanism for monetary policy.** The Federal Reserve conducts purchase, sale, and financing transactions in the Treasury market, including daily repo and reverse repo operations, as a means of supporting economic growth and keeping the federal funds rate in the target range set by the Federal Open Market Committee.¹⁶
- **It serves as a safe haven for investors in times of stress.** Investors have viewed Treasury securities as a risk-free or near-cash asset – assets that retain their value and can be easily sold during both normal and stressed market periods.¹⁷

VII. Recent Market Developments

At \$29 trillion outstanding, the Treasury market has grown since the pandemic, when it stood at \$17 trillion. The Congressional Budget Office forecasts it will nearly double in size over the next 10 years, with government deficits and the rising cost of interest payments pushing the market to more than \$52 trillion.¹⁸ This will boost the amount of collateral to be financed and pressure dealers to intermediate an even larger market.

The growth in the Treasury market and several market liquidity events have raised concerns regarding the resilience of the Treasury market. Over the last decade, the market has experienced several episodes of dysfunction, including in 2014, 2019, and following the COVID-19 pandemic. These episodes have caused the public and private sector to reassess the underlying safety and liquidity of the Treasury market, particularly its capacity to absorb and rebound from shocks.¹⁹

Questions regarding the functioning of the Treasury market surfaced following the “flash rally” in 2014, when Treasury yields fell and then quickly rebounded without a clear cause. The episode highlighted the role of high-speed electronic trading in the changing structure of the Treasury market, and prompted the Inter-Agency Working Group for Treasury Market Surveillance (IAWG) – composed of staff from the U.S. Department of the Treasury (U.S. Treasury), Board of Governors of the Federal Reserve System (Federal Reserve), Federal Reserve Bank of New York (FRBNY), Securities and Exchange Commission (SEC), and

¹⁶ Federal Reserve Bank of New York. (n.d.). Monetary Policy Implementation. Retrieved from <https://www.newyorkfed.org/markets/domestic-market-operations/monetary-policy-implementation>

¹⁷ Securities Industry and Financial Markets Association. (n.d.). Treasury Market Structure. Retrieved from <https://www.sifma.org/explore-issues/treasury-market-structure/>

¹⁸ Congressional Budget Office. (2025). The Budget and Economic Outlook: 2025 to 2035. Retrieved from <https://www.cbo.gov/system/files/2025-01/60870-Outlook-2025.pdf>

¹⁹ U.S. Department of the Treasury. (n.d.). IAWG Treasury Report. Retrieved from <https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf>

Commodity Futures Trading Commission (CFTC) - to review and make several recommendations to improve the resilience of the market.²⁰

Market functioning concerns were further amplified by Treasury funding market pressures in 2019, when repo rates increased in response to a shortfall of liquidity. The 2020 pandemic “dash for cash” resulted in dysfunction in the Treasury market. Prices for Treasury securities often rise as investors seek the safety of the instruments. But faced with significant uncertainty, investors sold Treasury securities to raise cash, causing Treasury prices to fall and strains in intermediation.

In both 2019 and 2020, the Federal Reserve intervened to restore Treasury market functioning, injecting liquidity into the market by purchasing and financing Treasury securities in large scale. During the pandemic, the Federal Reserve purchased at a pace not seen before, buying more than \$1 trillion in securities in just over 4 weeks, eventually bringing its balance sheet to an all-time high of more than \$8.5 trillion with Treasury security holdings of more than 25 percent of the market.²¹

Since the pandemic, the Treasury market has continued to experience bouts of volatility that have had echoes of prior events. For example, in 2023, amidst regional banking stresses, Treasury market volatility rose as investors became worried about the market risk of Treasury securities held by the banking system.

Most recently, the events that took place in April tested market functioning and prompted investors to question the resiliency of the market in the face of trade and policy uncertainty. Changes in trade policy prompted volatility across global asset prices that spilled over into uncertainty about the future direction of growth, inflation, interest rates, and the supply of Treasury debt.²²

Although Treasury markets often act as a safe haven in times of stress, in April, investors again began selling their Treasury holdings, pushing up interest rates and testing Treasury market functioning.²³ Measures of market liquidity - the ability to easily convert a Treasury security to cash - deteriorated measurably.

²⁰ U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, & U.S. Securities and Exchange Commission. (2014, October). Joint Staff Report: The U.S. Treasury Market on October 15, 2014. Retrieved from <https://www.sec.gov/files/treasury-market-volatility-10-14-2014-joint-report.pdf>

²¹ Federal Reserve Bank of Richmond. (2022). Econ Focus, Q3. Retrieved from

https://www.richmondfed.org/publications/research/econ_focus/2022/q3_federal_reserve

²² U.S. Department of the Treasury. (2025, April 29). Report to the Secretary of the Treasury from the Treasury Borrowing Advisory Committee. Retrieved from <https://home.treasury.gov/news/press-releases/sb0121>

²³ BNY. (2025, April 15). Cross-Border Outflows Persist in U.S. Fixed Income. Retrieved from <https://www.bny.com/corporate/global/en/solutions/capital-markets-execution-services/iflow/short-thoughts/cross-border-outflows-persist-in-us-fixed-income.html>

Treasury financing markets showed some initial signs of precautionary liquidity building, especially after a poorly received auction, with market participants shortening their positions, demanding higher levels of cash, and bidding up term repo rates. Additionally, swap spreads narrowed sharply, prompting concerns about a possible disorderly unwind of levered positions similar to the unwind of the cash-futures basis trade that amplified volatility during the pandemic.²⁴

As uncertainty eased, Treasury market functioning improved and funding market pressures lifted, but the events serve as a reminder that the continued safety and liquidity of the Treasury market are essential to its functioning.

VIII. Regulatory Developments and the Impact on Treasury Markets

Given the critical role of the Treasury market, over the last decade both the public and private sectors have stepped up their work to improve the resilience of the market.²⁵ Following the pandemic, the IAWG consolidated official sector efforts into five broad workstreams including:

- Improving the resilience of market intermediation,
- Improving data quality and availability,
- Evaluating expanded central clearing,
- Enhancing trading venue transparency and oversight, and
- Examining effects of leverage and fund liquidity risk management practices.²⁶

The changes being implemented as part of these workstreams represent the most significant changes to the Treasury market in decades.

One of the most consequential is the SEC's mandate for central clearing, which could require some \$4 trillion in daily transactions to be centrally cleared and is set to reassemble the structure of the Treasury market.²⁷ The rule will interpose a central counterparty (CCP) between the counterparties of every eligible transaction, making the CCP the buyer to every seller, and the seller to every buyer. Because CCP risk management includes margin, liquidity, and default management processes, counterparty credit risk in the Treasury market should be lower. This should enhance financial stability by improving the willingness of

²⁴ BNY. (2025, April 22). A Trio of Treasury Market Issues. Retrieved from <https://www.bny.com/corporate/global/en/solutions/capital-markets-execution-services/iflow/short-thoughts/a-trio-of-treasury-market-issues.html>

²⁵ For example, in 2021, the Group of 30 published a set of 10 recommendations to enhance Treasury market resilience. Link: https://group30.org/images/uploads/publications/G30_U.S._Treasury_Markets-Steps_Toward_Increased_Resilience_1.pdf

²⁶ U.S. Department of the Treasury. (n.d.). IAWG-Treasury-Report. Retrieved from <https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf>

²⁷ BNY. (n.d.). Central clearing: US Treasury market reassembly required. Retrieved from <https://www.bny.com/assets/corporate/documents/pdf/insights/central-clearing-us-treasury-market-reassembly-required.pdf>

market participants to continue trading in the Treasury market, even in times of stress when they might otherwise back away from their counterparties for fear of credit risk. Central clearing also should offer improved intermediation by providing some balance sheet relief through netting of offsetting transactions.

However, the rule will require market participants to change the way they interact in the Treasury market, including significant process, systems, legal, and operational changes required to centrally clear their transactions. CCPs also require their members to post margin and make contingent liquidity commitments, which could increase the cost of transacting in the market relative to current conditions, and increase the demand for liquidity to support margin in both normal and stress periods.

Although central clearing is the most significant of the efforts currently underway, the IAWG has already implemented a number of other changes that should support Treasury market functioning. Among other advancements, the IAWG data quality and availability workstream's efforts have improved market transparency through monthly publication of TRACE aggregate statistics on Treasury market activity and through the Office of Financial Research's data collection on non-centrally cleared bilateral repo transactions. The Federal Reserve in 2021 also launched the Standing Repo Facility, providing a liquidity backstop for Treasury and agency securities collateral.²⁸

XI. Public and Private Sector Solutions

BNY commends the Task Force for its work in examining the resilience of the Treasury market, particularly against the backdrop of these important market structure changes. The Treasury clearing mandate is only one of several public and private sector solutions that are important to strengthen the safety and liquidity of the market. I would highlight three priorities:

i. Improve Market Safety and Reduce Systemic Risk: Complete Treasury Clearing Implementation in a Timely Manner

We believe timely completion of the central clearing rule for the Treasury market is necessary to reduce counterparty credit risk and improve financial stability. To implement the Treasury clearing mandate, there are several important outstanding operational and regulatory issues that need to be resolved.

- **First, the implementation of mandatory clearing should provide a level playing field for all market participants.** The rule should apply to eligible transactions by CCP members wherever they are conducted and should not allow transactions to

²⁸ Board of Governors of the Federal Reserve System. (2021, July 28). Statement Regarding Repurchase Agreement Arrangements. Retrieved from <https://www.federalreserve.gov/newsevents/pressreleases/monetary20210728b.htm>

avoid central clearing simply because they are conducted in non-U.S. jurisdictions or settlement venues.

- **Second, implementation should be limited to Treasury securities transactions and not inadvertently capture non-Treasury trades.** The rule as currently proposed would cover repo trades that are commonly collateralized by baskets of mixed collateral types, including agency mortgage-backed securities, which could raise mortgage borrowing rates.
- **Third, continued industry and regulatory momentum is important in order to promote smooth implementation and avoid delays that lead to excessive transition cost.** In addition to timely resolution of the outstanding scoping issues above, documentation and infrastructure changes to support new access models, including done away clearing, should be made promptly.
- **Fourth, consistent margin practices should be implemented across the ecosystem and market participants.** Today, more than 70 percent of non-centrally cleared bilateral repo trades are transacted with zero margin, which could leave counterparties exposed to undue counterparty credit risk.²⁹ The clearing rule will require margin from CCP members but does not address the margin paid by non-CCP participants. The gap leaves the market with an unlevel playing field and conditions that result in a commercial race-to-the-bottom in risk management practices.³⁰ Efforts like those of the Treasury Market Practices Group to promote consistent margin practices should be implemented in conjunction with the clearing rule.^{31,32}

ii. **Promote Treasury Intermediation: Adjust the Leverage Ratio for Cash and Treasury Securities**

A safe and liquid Treasury market depends on the ability of firms to buy and hold U.S. Treasuries, and for banks and dealers to finance and intermediate those trades. These activities can be constrained by bank leverage ratios, especially in times of stress.

All U.S. banks must comply with the Tier 1 leverage ratio (T1LR); the largest U.S. banks must comply with the Supplementary Leverage Ratio (SLR); and the U.S. Global Systemically

²⁹ Office of Financial Research. (2023, May 12). Why Is So Much Repo Not Centrally Cleared? Retrieved from https://www.financialresearch.gov/briefs/files/OFRBrief_23-01_Why-Is-So-Much-Repo-Not-Centrally-Cleared.pdf

³⁰ Id.

³¹ Federal Reserve Bank of New York. (2025, February 26). TMPG Proposed Best Practices on Treasury Repo Risk Management. Retrieved from <https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG-Proposed-Best-Practices-on-Treasury-Repo-Risk-Management.pdf>

³² Commodity Futures Trading Commission. (n.d.). Treasury Cash & Futures Basis Trade Report. Retrieved from https://www.cftc.gov/media/11671/mrac121024_TreasuryCashFuturesBasisTradeReport/download

Important Banks must comply with the Enhanced Supplementary Leverage Ratio (eSLR).³³ Unlike risk-based capital, leverage-based capital is designed to be risk agnostic, meaning banks must hold the same amount of capital for reserves – cash held at the Federal Reserve – and U.S. Treasury securities as they would for more risky assets.

The leverage ratio was designed to be a backstop so that, in the event risk-based capital fell short, banks would still hold sufficient capital against leverage. Given changes in the size of the Treasury market and to monetary policy implementation, however, the leverage ratio has served as the binding constraint for many banks, limiting intermediation in the Treasury market.

In times of stress and volatility, investors often seek the safety of more liquid assets, including Treasury securities and cash. As a result, banks may see an increase in Treasury market financing and trading activity, and growing cash deposits from customers who liquidate or finance assets to build up cash holdings, held by banks in the form of reserves.

However, both activities can be bound by the leverage ratio because reserves and repo financing transactions drive up the assets on bank balance sheets, limiting the ability of banks to intermediate precisely when that intermediation is most needed. Asset purchases by the Federal Reserve aimed at restoring market functioning can further exacerbate leverage ratio constraints by ramping up bank reserve holdings. Recent research indicates that excluding cash and U.S. Treasuries from the SLR and T1LR would increase the ability of banks to intermediate in the Treasury market.³⁴ The adjustment would also be a more effective and targeted means of supporting Treasury market intermediation than alternatives such as reducing the overall ratio that might instead result in increased activity in riskier and higher-returning asset classes.

iii. Support Market Liquidity: Improve the Ability to Convert Treasury Securities for Cash

Additionally, we support faster, more reliable, and more efficient ways to exchange Treasury securities for cash. A more liquid market can help avoid market dysfunction by giving market participants the ability to easily convert their Treasury holdings to cash, making the need for large-scale central bank intervention more remote.

These solutions include:

³³Board of Governors of the Federal Reserve System. (2019, October 10). Requirements for Domestic and Foreign Banking Organizations Tailoring Rule Visual. Retrieved from <https://www.federalreserve.gov/aboutthefed/boardmeetings/files/tailoring-rule-visual-20191010.pdf>

³⁴ Bank Policy Institute. (2025, February 6). Treasury market resiliency and large banks' balance sheet constraints. Retrieved from <https://bpi.com/treasury-market-resiliency-and-large-banks-balance-sheet-constraints/>

- Modernizing the Federal Reserve Bank Discount Window operations, including harmonization of collateral processes with the Federal Home Loan Bank System where many smaller lenders and community banks hold collateral.
- Making it easier to move Treasury securities across collateral platforms to be able to access public and private liquidity sources, such as triparty repo, the FHLB platforms, the Standing Repo Facility, and the Discount Window.
- Expanding readiness and lowering the stigma to use the Discount Window and Standing Repo Facility so that they can be tapped readily.
- Providing additional options to convert Treasury securities to cash throughout the day, including through early morning and intraday repo. In the future, this could also include tokenized Treasury securities and settlement.

Together, these would improve Treasury market resiliency by making it easier to move collateral where it can be most effectively deployed to access liquidity.

XII. Conclusion

BNY remains committed to supporting the U.S. Treasury market and the vital role it plays in the lives of everyday Americans. We look forward to working with the Task Force to provide our expertise and perspective as it looks to bolster both the safety and liquidity of the Treasury market.

Chairman LUCAS. Thank you.

Dr. Duffie, I may have spent too much time in reconciliation markups in the last 10 days. You are now recognized for 5 minutes for your oral remarks.

STATEMENT OF MR. DARRELL DUFFIE, PH.D., ADAMS DISTINGUISHED PROFESSOR OF MANAGEMENT AND PROFESSOR OF FINANCE AT THE GRADUATE SCHOOL OF BUSINESS, AND PROFESSOR BY COURTESY, DEPARTMENT OF ECONOMICS, STANFORD UNIVERSITY

Mr. DUFFIE. Thank you, Chairman Lucas, and thank you for inviting me to testify today.

Weaknesses in the structure and regulation of the Treasury market raise the cost to American taxpayers for funding the government. These weaknesses also risk financial stability and effective monetary policy. For U.S. Treasuries to remain the world's premier safe haven asset and the anchor of dollar dominance, the intermediation capacity of the Treasury market must be greatly expanded.

Although, as you said, Chairman Lucas, there is no silver bullet for this, regulators could consider the following policies. One, fix the capital regulation known as the supplementary leverage ratio, or SLR. Two, encourage the emergence of all-to-all trade in the Treasury market. Three, transparently separate the Federal Reserve's purchases of Treasuries that support crisis market functioning from the Fed's other asset purchases. Four, make further use of the Treasury Department's buyback program. To my understanding, Chairman Lucas, Treasury market regulators have sufficient authorities from Congress to address these policies.

When COVID-19 became a global pandemic in March 2020, the Treasury market became dysfunctional because bond dealer balance sheets could not handle the surge of investor sales of Treasuries. Last month, tariff policy shocks threatened a similar crisis. Until concerns about the resilience of the Treasury market are addressed, bond investors who anticipate a need to raise cash quickly in a future crisis will reduce their everyday reliance on U.S. Treasuries. The cost to American taxpayers will rise correspondingly.

The SLR reduces the incentives of banks to buy safe assets. Reserves, Treasury repos, and short-term securities have very low risk but require the same SLR capital buffer as a risky real estate loan. The prices of long-term Treasuries, however, are volatile in a crisis and are not risk-free from the perspective of a bond dealer. If regulators do reduce the SLR for safe assets, the resulting reduction in bank capital should be offset with other changes in capital requirements.

The best capitalized dealers are those most able to provide liquidity to the Treasury market, especially during a crisis. Investors should be enabled to trade Treasuries not only with dealers but also directly with each other on all-to-all platforms. This would increase market capacity and resilience. It is notable that all-to-all Treasury futures markets maintained functionality even through the COVID shocks of March 2020.

Incentives for the emergence of all-to-all trade are improved by more central clearing, more post-trade price transparency, and

eliminating the market practice known as done-with trading, by which investors who clear transactions through a given dealer are required to also trade with that same dealer. Regulators should push further in all three of these directions.

Fed purchases of Treasuries to support market functioning will probably be necessary in some future crises but could act at cross-purposes with monetary policy or could even be confused with fiscal actions. The Fed should clearly distinguish its market function purchases from quantitative easing. Market resilience would also be enhanced if the Fed's Treasury market trades are settled at clearinghouses.

In some future crises, the Treasury Department could play its own liquidity backstop role by using its ability to buy back Treasuries. When Treasury Secretary Bessent was asked last month about tariff-related stresses in the Treasury market, he said, "We have a big toolkit that we can roll out. We could up the buybacks." I agree with that.

In conclusion, while already planned improvements in Treasury market regulation, especially expanded central clearing, as Mr. Wuerffel said, are helping, these are not nearly enough. The capacity of the Treasury market should be significantly expanded. Treasury market regulators are well-positioned to achieve this. Thank you.

[Prepared statement of Mr. Duffie follows:]

Hearing on

Examining Treasury Market Fragilities and Preventative Solutions

Testimony before the House Financial Services Committee
Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity

Darrell Duffie
Adams Distinguished Professor of Management and Professor of Finance
Graduate School of Business, Stanford University

May 15, 2025

Thank you for inviting me to testify on Treasury market fragilities and preventative solutions.¹ The burgeoning quantity of U.S. Treasury debt and weaknesses in the design and regulation of U.S. Treasury markets have reduced the reliability of the world's premier safe-haven asset. This raises costs to American taxpayers for funding government spending, erodes many other advantages to the United States of dollar dominance, and poses risks to financial stability and effective monetary policy.

Since the Global Financial Crisis (GFC), the intermediation capacity of the Treasury market is far more constrained by the balance sheets of primary dealers. Since 2007, for example, the quantity of Treasury debt held by the public, relative to the total size of primary-dealer balance sheets, has increased four-fold (Figure 1). This trend continues because of large U.S. fiscal deficits and post-GFC regulatory capital constraints, some of which are necessary for financial stability but constrain Treasury market intermediation capacity and liquidity during crises.

For U.S. Treasuries to remain the world's preferred safe-haven asset and the anchor of dollar dominance, the intermediation capacity of the Treasury market must be greatly expanded. Although there is no silver bullet for achieving this, regulators should fix the bank capital regulation known as the Supplementary Leverage Ratio (SLR), encourage (although not mandate) the emergence of all-to-all trade in the Treasury market, further exploit the Treasury Department's Buyback program, and ensure that the Federal Reserve's last-resort purchases of Treasuries to maintain market functionality are clearly

¹ This testimony includes, with permission, some passages from "[How US Treasuries Can Remain the World's Safe Haven](#)," Journal of Economic Perspectives, Volume 39, Number 2, Spring 2025. I am grateful for expert research assistance from Renhao Jiang and Hala Moussawi.

separated from the Fed's other asset purchases. To my understanding, Treasury market regulators already have sufficient authorities from Congress to address these objectives.

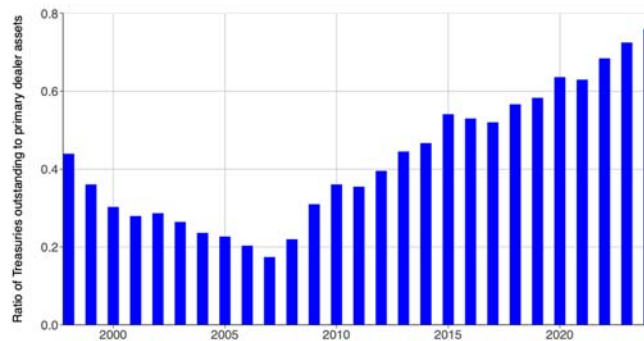


Figure 1. The ratio of US Treasury securities outstanding to primary dealer assets, 1998-2024. Data: The Federal Reserve and public company filings. Assets are measured at the holding-company level.

Dollar dominance is part and parcel with a deep and liquid Treasury market. U.S. Treasury securities are, by far, the first choice of safe-haven investors around the world. Treasuries serve two distinct safe-haven roles. First, they are a crisis hedge. As the risk of a crisis rises, global investors reduce risk by buying Treasuries and dollars in a flight to quality. With the tariff news that shook financial markets in early April of this year, it was worrisome that this historical pattern was broken when the market values of the U.S. Dollar and U.S. Treasuries dropped sharply together.

Figure 2 shows significant changes over time in the composition of investors in U.S. Treasuries. Since 2009, foreign investors, the largest of which are foreign central banks, have reduced their share of the total from over 50% to less than 35%. As the pace of Treasury debt issuance rises, it will be a challenge for the U.S. Government to attract enough demand for its debt by safe-haven investors without offering them higher yields.

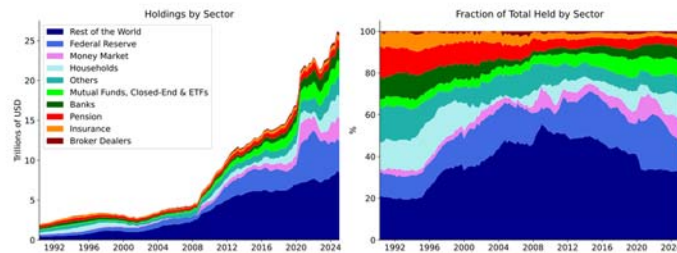


Figure 2. The composition of owners of U.S. Treasury securities, 1990 to 2025, from research in progress by Rafael Berriel, Miguel Chumbo, and Darrell Duffie. Data: [Federal Reserve, Financial Accounts](#).

More discretionary investors such as hedge funds and mutual funds will fill the gap, but with yet higher yields and less stable holdings.

The second safe-haven role of Treasuries is to act as a store of value that can be quickly liquidated for cash whenever a crisis hits. When this happens, the market must be able to quickly intermediate surging investor demands to sell Treasuries.² When the World Health Organization declared COVID-19 a global pandemic on March 12, 2020, the Treasury market was suddenly unable to meet this second safe-haven role effectively because bond dealers could not expand their balance sheets sufficiently to handle the flood of demands by investors around the world to sell their Treasuries. Total customer-to-dealer bond-market trade volumes suddenly jumped to over ten times their respective 2017-2022 sample medians.³ Bond dealers reached the limits of their intermediation capacity, and the Treasury market became dysfunctional.⁴ Dealer-to-customer bid-offer spreads and

² Duffie, Darrell (2023) "Resilience Redux in the US Treasury Market," in Structural Shifts in the Global Economy, A Symposium Sponsored by Federal Reserve Bank of Kansas, Jackson Hole Wyoming, August, 2023, pages 77-119.

³ Duffie, Darrell, Michael Fleming, Frank Keane, Claire Nelson, Or Shachar, and Peter Van Tassel (2023) "Dealer Capacity and US Treasury Market Functionality," Federal Reserve Bank of New York Staff Report 1070, October.

⁴ Bräuning, Falk, and Hillary Stein (2024) "The Effect of Primary Dealer Constraints on Intermediation in the Treasury Market," Federal Reserve Bank of Boston Working Paper 24-7, Federal Reserve Bank of Boston, July; Duffie, Darrell, Michael Fleming, Frank Keane, Claire Nelson, Or Shachar, and Peter Van Tassel (2023) "Dealer Capacity and US Treasury Market Functionality," Federal Reserve Bank of New York Staff Report 1070, October; and He, Zhiguo, Stefan Nagel, and Zhaogang Song (2022) "Treasury Inconvenience Yields During the COVID-19 Crisis," Journal of Financial Economics, Volume 123, 57-79.

market depth⁵ worsened by over ten-fold. Among other steps taken to backstop the market, the Federal Reserve purchased almost \$1 trillion dollars of Treasury securities from primary dealers in the first three weeks after March 12, freeing dealer balance-sheet space to handle more sales by domestic and global investors. Weak market functionality nevertheless persisted. Although Treasury market liquidity gradually returned to normal, many investors must have noticed that at the crux of the March 2020 crisis that they had not benefited from a liquid and deep Treasury market.

In early April of this year, tariff policy shocks threatened a similar crisis. As shown in Figure 3, a surge of Treasuries trading sharply increased the flow of risk onto dealer balance sheets. The depth of the market for 10-year Treasury notes on the largest dealer platform for trading Treasuries plunged on April 8 from a norm of about \$200 million to a mere \$30 million.⁶ A full-blown crisis in the Treasury market was averted when the Administration postponed its tariff plans.

The quantity of U.S. federal debt held by the public has now reached the level of U.S. GDP for the first time since World War II and is expected by the Congressional Budget Office to rise from about \$29 trillion today to approximately \$52 trillion by 2035, implying an even greater imbalance between the supply of Treasury securities and the surge intermediation capacity of Treasuries dealers. Bonds issued by other governments are unlikely to displace the premier safe-haven status of U.S. Treasuries for decades. But until concerns about the resilience of the markets for Treasuries are addressed, global investors who anticipate a need to raise large amounts of cash quickly in future crises will reduce their reliance on U.S. Treasuries. The cost of funding the U.S. government will rise correspondingly.

Improvements in Treasury market structure and regulation can increase the resilience of the Treasury market to future crises. Please let me suggest the following approaches for consideration by Treasury-market regulators.

⁵ Market depth is the quantity of securities that can be traded at prices that are within a defined difference from the midpoint price on the [Brokertec order-book market](#).

⁶ This is 2.4 standard deviations worse than the average depth over the preceding three years. Data: "US Treasury Market Daily, There's no crying in basis: Dissecting Treasury market liquidity, swap spreads, basis, and funding," J.P. Morgan, April 9, 2025.

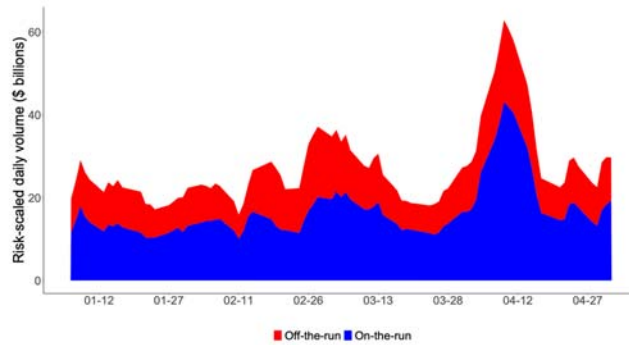


Figure 3. Risk-scaled daily volumes of trade in the market for U.S. Treasury notes, January through April 2025 (trailing 3-day average). Risk weighting is by approximate maturity and by Treasury yield volatility (MOVE). Data sources: [FINRA TRACE for Treasuries](#) and Bloomberg (MOVE).

Reducing the Distortionary Effect of Leverage-Based Capital Requirements

A leverage-based capital rule requires that a bank's capital exceeds a fixed fraction of its total assets—without considering the riskiness of the assets. Relative to foreign versions of leverage-based capital rules, the U.S. enhanced Supplementary Leverage Ratio (SLR) leans particularly heavily on the largest bank holding companies and thus on the largest primary dealers in the U.S. Treasury market.⁷ Leverage-based capital rules are distortionary. For instance, the SLR requires significant capital to cover losses on reserves held by banks at the Fed even though reserves have literally no risk of loss and are instantly liquid. Short-term Treasury securities and Treasury repurchase agreements (repos) have low risk but require the same SLR capital buffer per dollar of assets as a risky real-estate loan. By contrast, the prices of long-term Treasuries can be volatile, especially in crises, and are therefore not risk-free from the perspective of bond dealers.

In March 2020, amidst the crisis selling of Treasury securities, the balance sheets of the largest dealers became heavily loaded with bonds of all types, among many other assets. The SLR required some of the largest primary dealers to allocate significant amounts of

⁷ Tarullo, Daniel (2023) "Capital Regulation and the Treasury Market," Hutchins Center on Fiscal and Monetary Policy, Brookings Institution, March.

capital to their positions in Treasuries, Treasury repos, and reserves, even though these are on average very safe assets. The SLR inefficiently reduced the incentives of these dealers to absorb additional investor positions. On April 1, 2020, regulators recognized this impediment to market liquidity, exempting reserves and Treasuries from the SLR. Those dealers that were relatively more constrained by the SLR quickly reacted by committing relatively more of their balance sheets to Treasury positions.⁸ However, the SLR exemption lasted for only one year.

An exemption from the SLR for Treasuries (and perhaps reserves) was supported in early 2025 by the Jerome Powell, Chair of the Federal Reserve⁹ and by Treasury Secretary Scott Bessent.¹⁰ A much reduced role for leverage-based capital regulation, or a permanent exemption from the SLR for reserves and a major reduction in the SLR for Treasuries, would allow more efficient use of dealer balance sheets and improve the incentives of dealers to absorb more customer Treasury positions in a crisis.¹¹

The reduction in dealer capital implied by these changes to the SLR should be offset by changes in risk-based capital requirements. Without an offset, dealer capital levels would decline. Among other concerns, a decline in dealer capital would increase the interest rates that dealers pay to finance their inventories and reduce the incentives of dealers to offer liquidity to financial markets. Today, the best-capitalized dealers have lower debt funding costs and lower required returns on equity than less well capitalized dealers. Better capitalized dealers thus provide relatively more liquidity to their customers, especially during a crisis.

⁸ Bräuning, Falk, and Hillary Stein (2024) "[The Effect of Primary Dealer Constraints on Intermediation in the Treasury Market](#)," Federal Reserve Bank of Boston Working Paper 24-7, Federal Reserve Bank of Boston, July. The finding that SLRs constrained Treasury market intermediation was not confirmed in other research. See "[Dealers' Treasury Market Intermediation and the Supplementary Leverage Ratio](#)," Paul Cochran, Sebastian Infante, Lubomir Petrasek, Zack Saravay, Mary Tian, FEDS Notes, October 2024, Federal Reserve Board.

⁹ "[Powell Says Easing Bank Capital Requirements Could Help Treasury Market](#)," Wall Street Journal, February 12, 2025.

¹⁰ Bessent, Scott (2025) "[Remarks at the Economic Club of New York](#)," US Treasury Department, Washington, March 6, 2025.

¹¹ Duffie, Darrell (2022) *Fragmenting Markets: Post-Crisis Bank Regulations and Financial Market Liquidity*, DeGruyter: Berlin; Group of Thirty (2021) "[US Treasury Markets: Steps Toward Increased Resilience](#)," G30 Working Group on Treasury Market Liquidity, Group of 30, Washington, DC, July.

All-to-all trade

As the Treasury market continues to grow, I expect exchange entrepreneurs to introduce venues at which investors can trade Treasuries (and perhaps Treasury repos) not only with dealers, but also directly with each other, thus expanding market capacity.¹² Congress and regulators should strongly encourage the emergence of all-to-all trade, but forcing this outcome with prescriptive regulation could have unintended adverse consequences for market liquidity. Dealer-intermediated trade is also crucial to market liquidity.

Once all-to-all platforms for trading Treasuries emerge, investors will continue to conduct many of their trades directly with dealers. But the option to trade on all-to-all platforms will improve competition, market efficiency,¹³ and market resilience. Notably, all-to-all Treasury futures markets maintained their functionality even through the COVID shock of March 2020. Incentives for the emergence of all-to-all trade of Treasury securities are improved by (1) greater use of central clearing,¹⁴ (2) more post-trade price transparency,¹⁵ and (3) avoiding the “done-with” practice by which dealers require that customers who clear their Treasuries trades through a dealer must also trade with the same dealer.¹⁶ Regulators should push further in all three of these directions.

Market-functioning purchases by the Fed and Treasury Department Buybacks

In a future crisis, Fed purchases of Treasuries to support market functioning may once again become necessary as a last resort,¹⁷ but could act at cross purposes with monetary policy or could even be confused with fiscal actions by the Fed.

¹² Chaboud, Alain, Ellen Correia-Golay, Caren Cox, Michael Fleming, Yesol Huh, Frank Keane, Kyle Lee, Krista Schwarz, Clara Vega, and Carolyn Windover (2022) “All-to-all Trading in the US Treasury Market,” Federal Reserve Bank of New York Staff Report No. 1036, October.

¹³ Allen, Jason and Milena Wittwer (2023) “Centralizing Over-The-Counter Markets,” Journal of Political Economy, 131, 3310–3351; Kutai, Ari, Daniel Nathan, and Milena Wittwer (2023) “Exchanges for Government Bonds? Evidence During COVID-19,” Working paper, Bank of Israel, July.

¹⁴ Duffie, Darrell (2020) “Still the World’s Safe Haven? – Redesigning the US Treasury Market After the COVID-19 Crisis,” Hutchins Center Working Paper 62, Brookings Institution, May; DTCC (2024) “The US Treasury Clearing Mandate: An Industry Pulse Check,” DTCC White Paper, Depository Trust and Clearing Corporation, July.

¹⁵ Brain, Doug, Michiel Pooter, Dobroslav Dobrev, Michael Fleming, Pete Johansson, Colin Jones, Frank Keane, Michael Puglia, Liza Reiderman, Tony Rodrigues, and Or Shachar (2018) “Unlocking the Treasury Market through TRACE,” FEDS Notes, September.

¹⁶ Clancy, Luke (2025) “PTFs clash with banks over ‘done-away’ US Treasury clearing,” Risk.net, March 14.

¹⁷ Fleming, Michael, Haoyang Liu, Rich Podjasek, and Jake Schurmeier (2022) “The Federal Reserve’s Market Functioning Purchases,” Economic Policy Review Number 28, Federal Reserve Bank of New York, June; Bernardini, Marco, and Annalisa De Nicola (2020) “The market stabilization role of central bank asset

In some cases, not all, the Treasury Department could also play an important backstop role in a crisis to support market functioning.¹⁸ The Department of the Treasury recently instituted a Buyback program, by which it re-purchases (“buys back”) less liquid Treasury securities from primary dealers. In normal times, regular and predictable buyback purchases improve Treasury market liquidity¹⁹ and reduce the outstanding stock of illiquid off-the-run Treasuries that could later be sold to dealers during a crisis. The Treasury Department’s Buyback program therefore reduces the extent to which dealer balance sheets could become clogged with illiquid securities in a future crisis. Treasury Secretary Bessent recently commented that the Buyback program could indeed address Treasury market instability, saying that “we have a big toolkit that we can roll out ... we could up the buybacks if we wanted.”²⁰

In some future crises, Fed purchases to support market functioning may not naturally align with the Fed’s monetary policy. This sort of misalignment happened when the United Kingdom had severe fiscal problems in September 2022. The Monetary Policy Committee of the Bank of England had previously decided to begin selling gilts (the British equivalent of Treasury securities) to maintain price stability, a monetary policy goal. But within a day of the MPC’s announcement, a U.K. fiscal budget crisis caused a fire sales of gilts by “liability-driven investors.” This destabilized the gilt market, leading the Financial Policy Committee of the Bank of England to institute a program of gilt purchases that helped to restore gilt market stability.²¹ Bank of England Governor Andrew Bailey commented “There may appear to be a tension here between tightening monetary policy as we must, including so-called Quantitative Tightening, and buying government debt to ease a critical threat to financial stability. This explains why we have been clear that our interventions are strictly temporary and have been designed to do the minimum necessary.”²² Drawing from this U.K. experience, the Fed should set out a clear policy of distinguishing its market-

purchases: high-frequency evidence from the COVID-19 crisis,” Working paper 1310, Banca d’Italia, December; Duffie, Darrell and Frank Keane (2023) “Market-Function Asset Purchases,” Federal Reserve Bank of New York Staff Report 1054, February.

¹⁸ Duffie, Darrell and Frank Keane (2023) “Market-Function Asset Purchases,” Federal Reserve Bank of New York Staff Report 1054, February.

¹⁹ Jing Zhou (2025) “Testing the Liquidity Support Effects of the U.S. Treasury Buyback Program,” IMF Working Paper 2025-088, May.

²⁰ “Bessent Says Treasury Has Big Toolkit if Needed for Bonds,” Bloomberg News, April 14, 2025.

²¹ Hauser, Andrew (2022) “Thirteen Days in October: How Central Bank Balance Sheets Can Support Monetary and Financial Stability,” Speech given at the ECB’s 2022 Conference on Money Markets, Bank of England, November.

²² Bailey, Andrew (2022) “Monetary Policy and Financial Stability Interventions in Difficult Times,” speech presented at the G30 meeting in Washington DC, Bank of England, October.

functioning purchases from monetary policies such as Quantitative Easing, with separately defined entry and exit criteria and separate strategies for purchasing and then selling.²³

The Federal Reserve's Treasury-market operations should also be settled at the same clearinghouses used by dealers. With this, dealer balance sheet space that is tied up for the settlement of customer trades can be reduced by netting customer trades against trades with the Fed. These netting offsets are especially important in a crisis that threatens to overwhelm the available space on dealer balance sheets.

In conclusion

The approaches on which I have focused are not exhaustive---every opportunity to improve Treasury market efficiency should be considered by policy makers. For example, in the not-so-distant future, Treasury securities will be more widely available in a tokenized form, making them accessible 24 x 7 x 365 globally, further improving the liquidity of Treasury markets and investor demand for U.S. Treasury debt.²⁴ Congress and Treasury market regulators should be open to supporting this development.

U.S. Treasuries will likely remain the world's premier safe-haven asset for decades to come. No serious contender is in sight. The paramount concerns of policy makers should be the rapidly increasing quantity of Treasury debt and how much more costly it will be for the U.S. government to finance itself if it does not sufficiently shore up the resilience of Treasury markets. While already planned improvements in Treasury market regulation and design--such as increased central clearing--are helping, these are not nearly enough.²⁵ The crisis capacity of the Treasury market should be significantly expanded. Treasury market regulators are well positioned to accomplish this critical objective.

²³ Duffie, Darrell and Frank Keane (2023) "[Market-Function Asset Purchases](#)," Federal Reserve Bank of New York Staff Report 1054, February.

²⁴ "[Digital Assets and the Treasury Market](#)," Treasury Borrowing Advisory Committee presentation, October, 2024.

²⁵ Interagency Working Group (2023) "[Enhancing the Resiliency of the US Treasury Market: 2023 Staff Progress Report](#)," U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, U.S. Securities and Exchange Commission, and U.S. Commodity Futures Trading Commission, Washington DC, November.

Chairman LUCAS. Thank you.

Mr. Jersey, you are now recognized for 5 minutes for your oral remarks.

STATEMENT OF MR. IRA JERSEY, CHIEF U.S. INTEREST RATE STRATEGIST AND GLOBAL RATES TEAM LEADER, BLOOMBERG INTELLIGENCE

Mr. JERSEY. Chairman Lucas, Ranking Member Vargas, and members of the Task Force, thank you for the opportunity to appear today. I am Ira Jersey. I serve as the chief U.S. Interest Rate Strategist for Bloomberg Intelligence, a research arm of Bloomberg LP. These views are mine alone and not necessarily those of Bloomberg or any of its employees.

While the Treasury market remains the most liquid bond market in the world, that liquidity can sometimes be an illusion. We have repeatedly seen that in periods of stress or volatility, market depth can quickly vanish. This is not new. I warned of this fragility well over a decade ago, and recent episodes continue to underscore the challenges to liquidity in the world's most important market. I believe the root cause of these liquidity issues are structural and not easily rectified.

Since the 2007 to 2009 global financial crisis, we have adopted regulations rightly aimed at ensuring a safer and fairer financial system, but they have come at a cost. Balance sheet constraints have reduced the capacity of market makers to provide liquidity during times of stress. Put differently, we traded a more resilient financial system for less resilient markets.

This trade may be acceptable in principle, but we must be honest about its consequences. Also, the amount of Treasury securities outstanding also matters to market function. Market intermediaries such as dealers and banks do not have enough balance sheet flexibility to efficiently make markets in times of stress while also complying with all of these requirements.

Many of the often-suggested fixes will be helpful to market function but none are sufficient to prevent bouts of volatility. Central clearing of Treasuries and repurchase agreements, for example, will help prevent market dysfunction, but functioning markets do not prevent prices from moving sharply. One promising tool has been the sponsored repo market, which allows more efficient funding of Treasury positions.

Use of sponsored repo has grown to about \$2 trillion, representing a substantial amount of repo trades tied to Treasury transactions but sponsored repo growth has recently stalled due to counterparty limits and delayed implementation of central clearing. Exempting Treasuries from the supplementary leverage ratio can also be helpful to liquidity generally, but it is not a silver bullet.

Other regulatory constraints, like liquidity coverage ratio and the net stable funding ratio, continue to limit how much risk banks and dealers can take and absorb, especially during volatile periods. Together, these rules discourage expanding balance sheets just when the market needs those balance sheets most.

The market structure has also changed. High-frequency trading firms now account for a large share of activity, but they tend to pull back during periods of volatility. High-frequency trading firms

contribute to the illusion of liquidity where the market seems deep until it suddenly is not.

Additionally, we need to be cautious about how we interpret recent volatility. Some worry that the use of leveraged basis trades involving Treasury futures and cash bonds has increased instability, but there is little evidence of a large-scale unwind. Futures open interest remains steady, repo markets are functioning, and money markets have not fled to the Fed's RRP facility. Basis trades fears seem to be overstated.

Finally, we must recognize that demand for global Treasuries is ever-changing. Private foreign investors now hold more long-term U.S. debt than official institutions like central banks and sovereign wealth funds. That means more market risk is concentrated in hands that are sensitive to returns and hedging costs, not necessarily government policy mandates.

Another major shift in the past decade is domestic buyers having supplanted foreigners as the major purchaser of Treasuries, even following the end of the Federal Reserve's asset purchase program. Ultimately, the decision to purchase a Treasury security is one of economics. Does owning a Treasury at a specific yield meet the need of an investment mandate? Does it fulfill a regulatory requirement? Is it at a market price where I think I can sell it for a profit or at least not a loss? These are just a sample of why Treasuries are purchased, but ultimately, it comes down to price. During periods of uncertainty or one-way trading, prices will move to meet demand.

In closing, improving Treasury market resilience requires a comprehensive coordinated approach. There is no single fix that will change this issue. Volatility regularly occurs even within highly functioning markets, but there are always ways to make the market more elastic, such as allowing targeted regulatory flexibility during times of stress so that dealers can step in when they are needed most. That would give us a safety valve without compromising long-term financial stability.

Thank you. I look forward to continuing this discussion.

Prepared statement of Mr. Jersey follows:]

Testimony of Ira Jersey

For the U.S. House of Representative's Financial Services Committee Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity.

This testimony is my work alone. Although I am Chief US Interest Rate Strategist for Bloomberg Intelligence (BI), a research division of Bloomberg LP, these views are mine alone, and not necessarily those of Bloomberg LP or any of its employees.

May 15, 2025

Chairman Lucas, Ranking Member Vargas, and Members of the Task Force, I appreciate the opportunity to discuss with you potential changes in financial regulations that may enhance the liquidity of the most important market in the world – U.S. Treasuries. Recent events have highlighted that liquidity in this market can sometimes be fragile. For over a decade I've highlighted there is often an illusion of Treasury market liquidity, that vanishes during high volatility periods. In fact, in December 2014, I wrote that Treasury market liquidity had become fickle – which hasn't changed and may have become somewhat worse.

The key points of my testimony today include:

1. Market volatility is not unusual, and while some recent intraday moves have seemed unusual, they are not in a longer term historical context;
2. Rules and regulations designed to reduce the risk of institutional and market failure have also created an environment where market-making type activities have not been able to keep pace with the growth of the Treasury market;
3. Enhancing Treasury market liquidity will require the reshaping of many financial rules. For example, I believe exempting Treasuries from the Supplementary Leverage Ratio is a positive step for market liquidity, but by itself isn't enough to quell potential market illiquidity.

Treasury Market Liquidity Unparalleled, Yet Volatility Still Likely as Capital Rules Impede Balance Sheet Elasticity

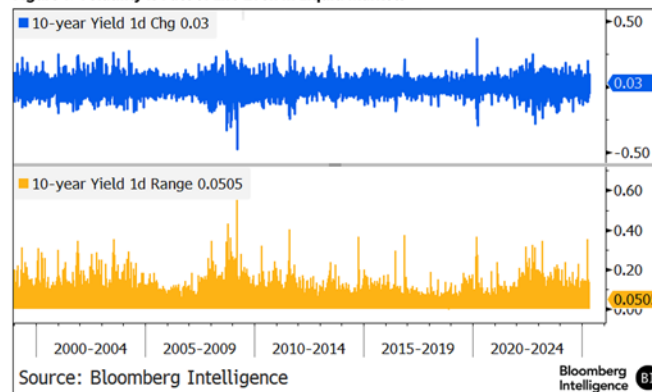
When discussing Treasury market fragility and methods to mitigate these risks, we need to start by defining liquidity. If it's defined as the ability to transact on demand at a low cost (ie tight bid/offer spreads) without large price moves, then the US Treasury market is by far the most-liquid bond market in the world. But at times liquidity can be illusory, in that the market is very efficient during normal times, but there can be periodic interruptions. During periods of one-way trading, prices often fall or jump swiftly.

Financial regulations may need to balance the need for safe and robust financial institutions, while allowing market-makers and other financial intermediaries to provide liquidity based on the market environment.

Since 2013, fears of declining Treasury market liquidity have risen, particularly since the 2014 flash rally and the implementation of the Basel bank capital rules and Dodd-Frank financial regulations. These rules and regulations created sound financial institutions, but the flip-side is less flexibility within the overall financial system. Effectively there was an unintended trade-off that occurred: the risk of additional market volatility was exchanged for sounder financial institutions. This is a trade-off that policymakers could embrace, as market volatility is less costly for taxpayers than complex workouts of financial institutions.

Treasury market volatility isn't unusual in a historical context (Figure 1). Even before the 2007-2009 Global Financial Crisis, Treasury yields regularly traded in broad ranges similar to today.

Figure 1: Volatility Is Fact of Life Even in Liquid Markets



There isn't a single rule or change that will suddenly and permanently increase Treasury market liquidity, and these rules aren't confined to dealers or banks; they also include mutual-fund liquidity rules, central counterparty margin requirements, and insurance company regulations, among many others. Among these, changes to bank capital rules may have the lowest barriers to amend.

Many bank capital regulations were implemented following the 2007-2009 Global Financial Crisis, some of which work at odds with each other. These rules seem to have incentivized some of the largest banks to maximize capital utilization, leaving little room to expand market-making operations or provide leverage to clients like hedge funds, which might otherwise be willing to take advantage of relative-value opportunities amid volatility.

Figure 2: Large Bank Basel Capital Regulations

Metric	Brief Description	Primary Constraint
Leverage Ratio	Global non-risk based measure of leverage that includes on and off balance sheet exposure, requiring capital to be held against assets	Assets/Equity
Supplementary Leverage Ratio	US specific non-risk based measure of leverage that includes on and off balance sheet liabilities, including derivatives, secured financing (repo), and untapped revolving loans	Assets/Equity
Enhanced Supplementary Leverage Ratio	Stricter version of the SLR for the largest, most important US financial institutions	Assets/Equity
Liquidity Coverage Ratio	Measure to protect against bank deposit outflows by mandating minimum high quality liquid asset holdings to meet a modeled 30-day outflow scenario	Assets
Net Stable Funding Ratio	Requires bank liabilities (funding) come from stable sources over a longer time horizon such as sticky deposits and longer term debt, vs short term wholesale borrowing	Liabilities
TLAC Requirements	Requirement for the largest, most important US financial institutions to protect taxpayers from bailout costs by shifting losses to equity and debt capital investors	Equity/Liabilities
Risk Weighted Capital Ratio	Amount of equity capital banks need to hold against their assets, weighted by the risk of those assets. Risk of default, maturity risk, and operational risks are considered.	Equity/Assets

Source: Bloomberg Intelligence

Bloomberg
Intelligence

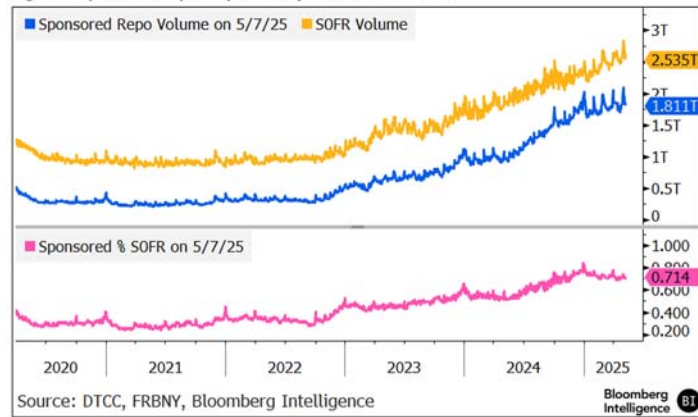
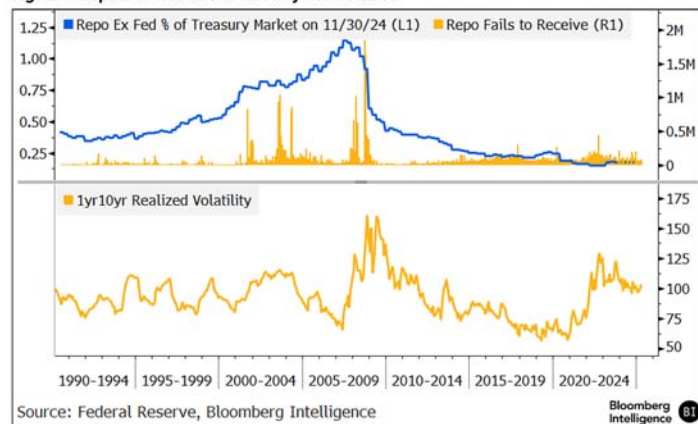
Robust and Elastic Funding Markets Enhance Trading

Unlike many other global sovereign bond markets, Treasuries enjoy a deep and easy means to fund transactions for short term trades - primarily in the repurchase agreement market. In recent years, the repurchase agreement innovation known as sponsored repo, which allows dealers to net fund trades that are cleared through the Depository Trust & Clearing Corp. (DTCC). Since late 2022, the use of sponsored repo has climbed to more than 70% of the market used to make up the secured overnight-financing rate (SOFR). Counter-party limits and regulatory shifts such as delays in central clearing, have slowed the growth of this market since late 2024.

About 80% of dealer trades are on-the-run securities and includes 60% of funding need. Since most of these trades can't be netted, dealer balance sheets can easily get constrained by funding and the 40% of off-the-run securities. Since late 2022, the use of sponsored repo has climbed to more than 70% of the market used to make up the secured overnight-financing rate (SOFR) (Figure 3). Counter-party limits and regulatory shifts such as delays in central clearing, have slowed the growth of this market since late 2024.

Before the financial crisis, the repurchase-agreement market was larger than the amount of Treasury notes and bonds outstanding. The repo market size surged from the mid-1990s following implementation of the first round of Basel bank capital rules. In the mid-2000s, when realized rate-market volatility was low, relative-value investors did highly levered trades between Treasury instruments. Some securities were reportedly rehypothecated (reuse of collateral) multiple times, eventually triggering a major unwind of trades and more fails in funding markets (Figure 4).

Today's rules take the opposite approach. The net stable funding ratio (NSFR), for example, precludes banks and their dealer arms from expanding their balance sheets quickly to balance market supply/demand dynamics. Limits should be kept, but there may be room for flexibility.

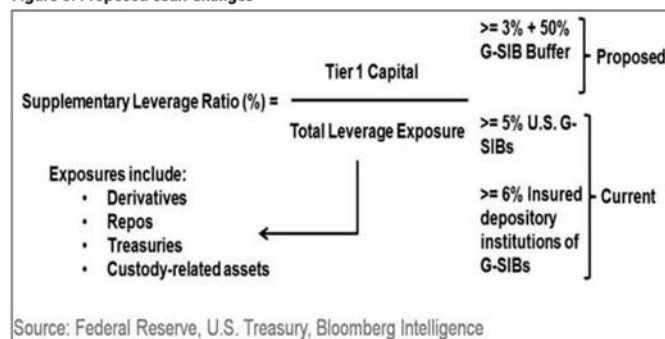
Figure 3: Sponsored Repo Helps But May Have Reached Limit**Figure 4: Repo Market Share of Treasury Has Declined**

SLR Shift Incremental Help, Dealer Risk Review

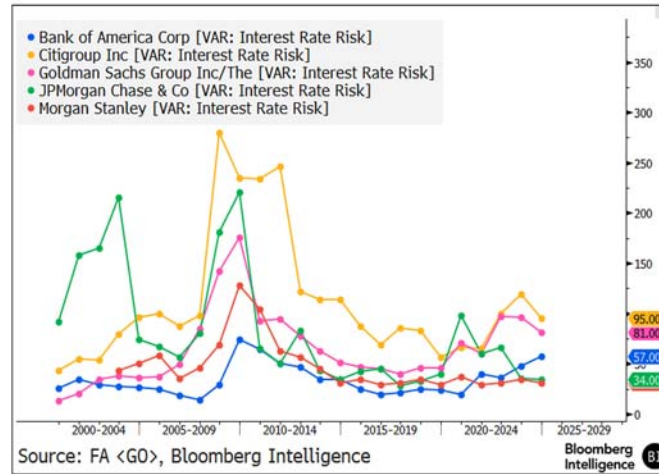
An often-touted regulatory change is to exempt Treasuries from the calculation of the enhanced supplementary-leverage ratio (SLR) for systemically important banks. Such a change would incentivize banks to own more Treasuries per unit of equity capital, but other rules would continue to limit the ability of banks and their dealer arms to fund these positions. Other leverage ratios, the liquidity-coverage ratio (LCR), and the net stable-funding ratio (NSFR) are among other limits on how large bank and dealer Treasury positions might become.

Even exempting Treasuries from all these rules wouldn't have the desired effect. For every asset owned by a financial institution, there is an offsetting liability. Repurchase agreements and other non-deposit funding remains constrained by capital rules.

Figure 5: Proposed eSLR Changes

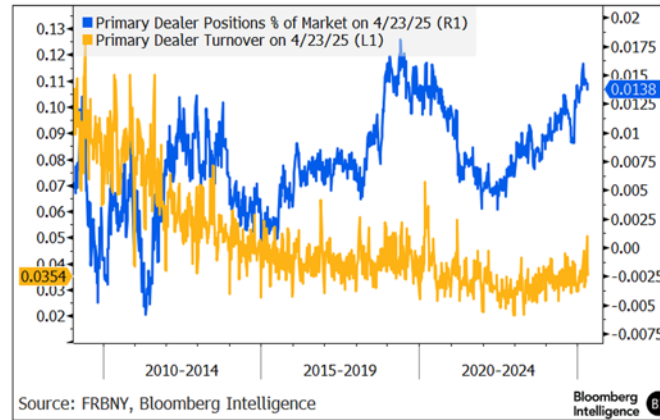


Several banks have increased interest-rate risk over the past few years, but others have maintained relatively low rate exposure in general (Figure 6). The ability to hedge interest-rate exposure by using levered instruments such as futures and interest-rate swaps are an important factor creating a robust and deep rate market. The recent failures of Silicon Valley Bank and Sovereign Bancorp were in part triggered by inadequate interest-rate hedging, but these weren't due to the lack of instruments to hedge this exposure.

Figure 6: GSIB Interest-Rate Risk Remains Contained

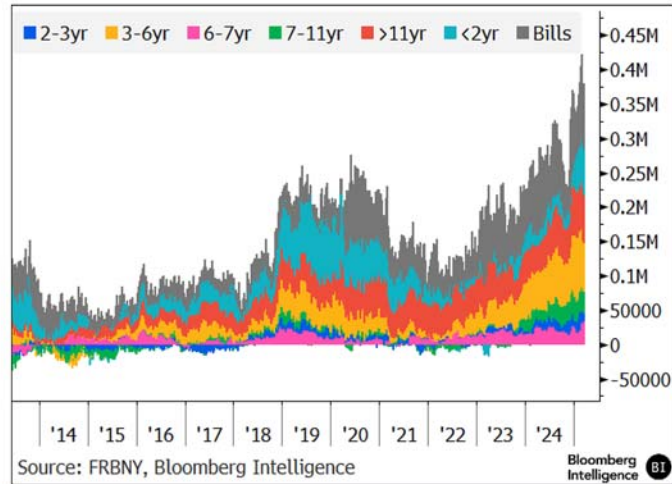
Dealer weekly trading is about 3% of the market, down from 7% during the financial crisis (Figure 7). With the size of the Treasury market now some 400% larger than it was in early-2009, without similar increases in dealer balance-sheet capacity. Other structural shifts in the market, however, also reduce the need for dealer participation outside of stressed periods, particularly high-frequency traders (HFTs) that trade for their own book and provide liquidity, but often pull back when volatility increases. In 2019, the New York Federal Reserve estimated 21% of Treasury activity was from these firms (see link left), which likely has increased at the expense of dealers since that time.

This is a reason why there's a illusion of liquidity; markets are very deep most of the time, but market depth dries up swiftly when volatility increases.

Figure 7: Dealer Turnover and Positions Share of Market

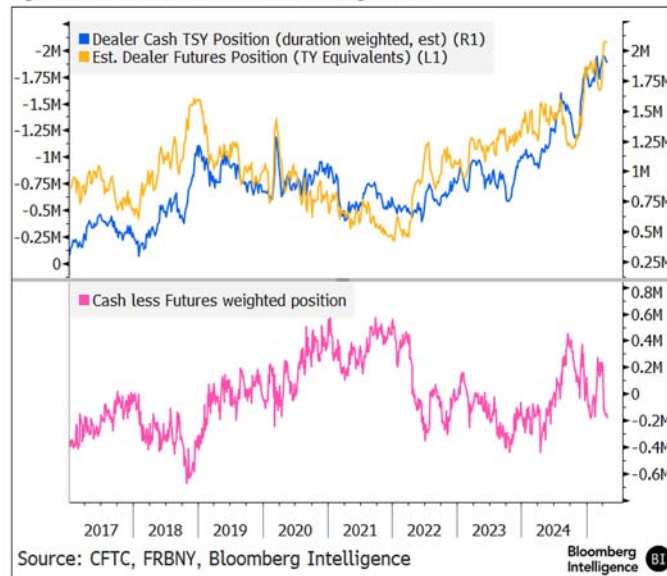
Dealers added to Treasury positions following large selloffs in 2021 and 2022. When dealer positions become large, incremental additions and market-making activity during times of volatility may be more difficult. Given the near record notional value and risk (read DV01) of dealer balance sheets going into early April, it's not surprising that volatility ensued as headlines drove investors to swiftly shift positions (Figure 8). Market action during overnight hours can also be constrained by lack of intermediaries available to take risk. Asian trading desks tend to have smaller risk limits than in London or New York.

"All-to-all" trading might not generate the liquidity and mitigate the volatility that some hope. When markets become one-way, bids are pulled swiftly. High-frequency traders, for example, step away during high-volatility periods.

Figure 8: Dealer Positions in Cash Treasuries

Shallower market depth and wider bid-offer spreads always accompany bouts of increased market volatility, yet financial-sector balance sheets matter for the extent that liquidity declines. Dealers, in particular, might still find it difficult to expand balance sheets in times of stress. Since late 2023, dealers have added to cash Treasury positions as they shorted Treasury futures.

A means to help dealers step into volatile markets would be to ease capital requirements in times of extreme market volatility. The rule would need to have triggers that become effective when certain intraday volatility thresholds are met, and would need to be at the discretion of the dealer to be effective. This "volatility backstop" would need to be sufficient for dealers to hold Treasuries though funding via the repurchase-agreement market.

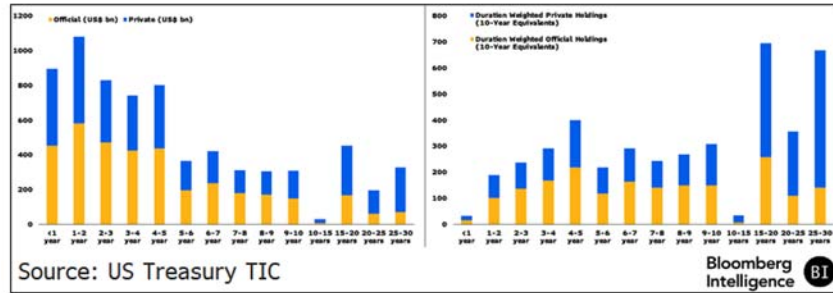
Figure 9: Dealers Forced Into Basis Trade as Hedge to Cash

Private Foreign Investors Own Most Treasury Risk

Foreigners own about 31% of Treasury securities totaling \$8.8 trillion dollars. A bit more than half are held by foreign private investors for investment purposes. This is a major shift since 2010, when nearly three-quarters of foreign held Treasuries were held by official institutions (primarily foreign-currency reserve managers and sovereign wealth funds). The uptick in private purchases corresponds with US Treasuries yielding more than other debt after hedging the currency exposure. Therefore, if currency-hedging costs shift, so might the willingness to hold US Treasuries.

Although private and official ownership of shorter-term securities is about equal, private investors own much more long-maturity bonds. Once this debt is risk-weighted for duration, private investors own much more risk than official institutions.

Figure 10: Foreign Treasury Ownership by Maturity: June 2024

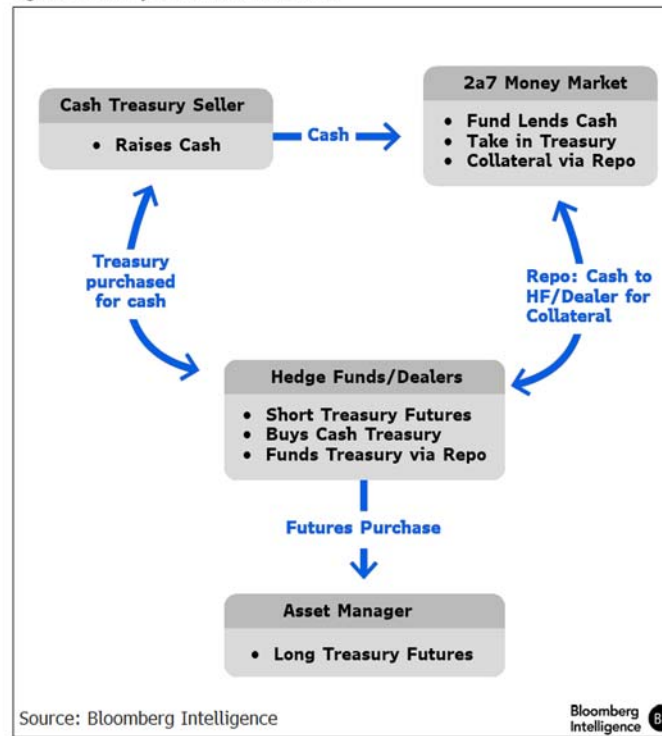


April Treasury Volatility Not Due to Futures Basis Trade Unwind

Some are scared that Treasury futures against cash securities basis trades could be exacerbating volatility in the market, something we think hasn't occurred. If there's such an unwind, it would have several noticeable market effects. First, cash securities would be selling off vs. futures (they aren't). Second, open interest in contracts where the basis trade is known to be large would be falling swiftly (they aren't). Third, money funds would likely be reducing their reliance on repo and using the Federal Reserve's RRP facility to a greater extent (RRP facility usage has fallen).

The exhibit is a simplified anatomy of a cash Treasuries vs. futures basis trade. In a traditional basis-trade unwind, you'd expect all three outcomes to occur in some meaningful magnitude.

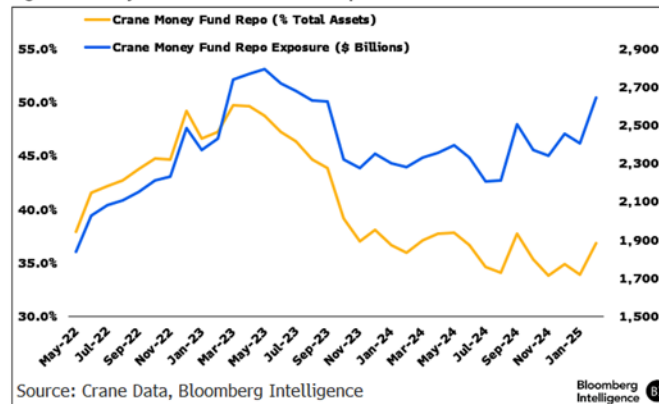
Figure 11: Anatomy of Traditional Basis Trades



A decade ago, most rule 2a7 money-market mutual funds were incentivized to move to be government-only funds, investing in Treasury bills, GSE discount notes, and repos collateralized by government securities. This has led to over one-third of money-fund assets being in repos -- or nearly \$2.7 trillion. Money funds are able to lend their cash to dealers and hedge funds to facilitate levered long Treasury positions. If basis trades were unwinding, with levered longs selling cash securities, one effect would be a decline in repo by money funds.

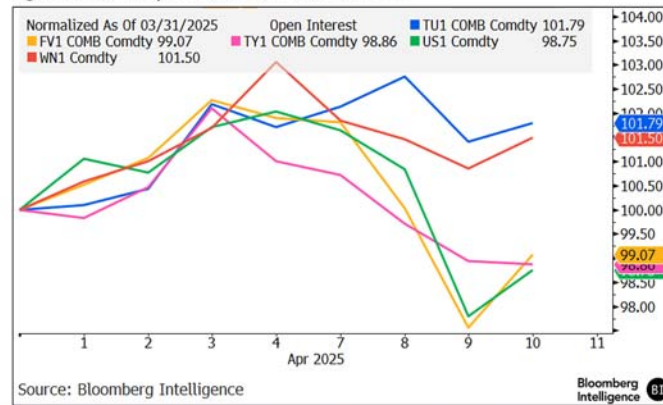
Money fund managers would respond by purchasing T-bills or using the Fed's RRP facility. It's not clear there's been an uptake in T-bills by 2a7 funds, and the RRP facility use has actually declined the last week. In fact, indirect take of last week's T-bill auctions was unremarkable.

Figure 12: Money Funds have \$2.7 Trillion in Repo Market



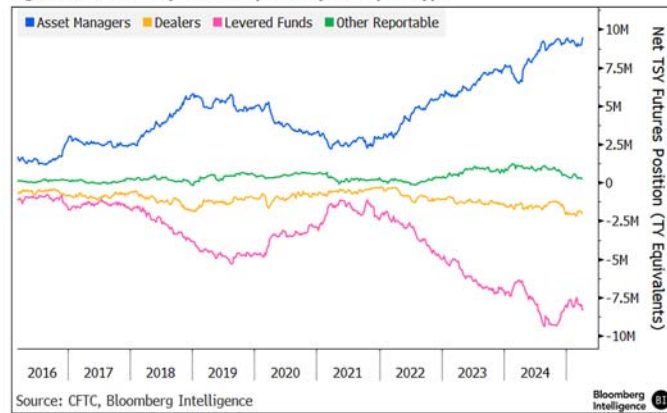
If the futures basis trades were being unwound in any systemically important way, the open interest across the Treasury futures complex would be reduced far more drastically than it has been through the April 10 close. If levered participants are "long" the basis, they are short Treasury futures, and long the underlying cash Treasury. The unwind of this trade would see large futures buying to cover the existing short, and a reduction of open interest as the trades are closed out -- not to mention the hit to funding markets.

Given the prevalence of basis activity in two- (TU), five- (FV), and 10-year (TY) futures, the relatively sharp reduction in 5-year activity highlights some pressure, but the move's magnitude was fairly benign. Some of the reduction was likely due to stop-outs given the pronounced intraday volatility.

Figure 13: Futures Open Interest Hasn't Declined Much

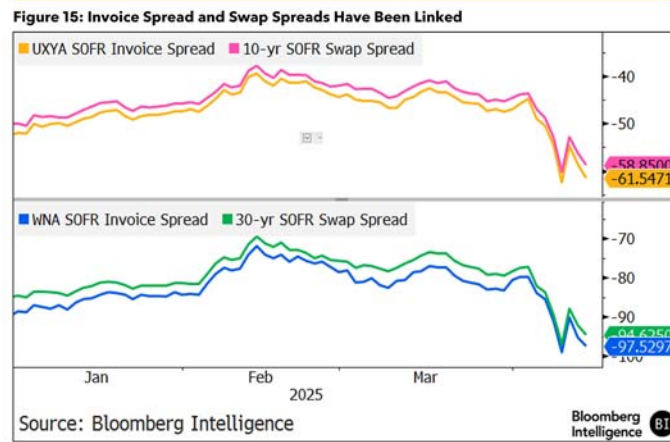
Cash-Futures Basis Is Created by Asset Managers

Regulators often point fingers at basis traders, which is unsurprising given the inherent leverage and inability to monitor the underlying funding market. However, they are merely economic actors exploiting a profitable opportunity -- one created by the outsized demand for Treasury futures vs. cash Treasuries from asset managers. Broadly, asset managers use Treasury futures given the balance-sheet efficiency and liquidity, as well as their embedded leverage. Repo is far less common than futures as a source of leveraged duration exposure, due to potential mandate constraints and flow-through to expense ratios. This creates excess demand for futures, richening them relative to the deliverable cash-Treasury. As delivery dates approach, the basis decreases, as the underlying Treasury and future price coalesce.

Figure 14: Net Treasury Futures Exposure by Participant-Type

The recent research report by Brian Meehan, from the Bloomberg Intelligence fixed income market structure team, notes that swap spreads are where the action has been. We add that it's both swap spreads and Invoice Spreads (the swap rate less implied Treasury-futures yield). Because traditional basis trades haven't unwound (yet), it appears that swap-spread widening positions have been liquidated. Prior to last week's extreme volatility, most had thought (and seemingly positioned for) swap spreads to widen toward minus 50 bps as the regulators prepared to exempt Treasuries from the supplemental leverage ratio (SLR), thereby increasing Treasury demand, and reducing reliance on swaps to get long exposure.

As the long end of the yield curve sold off last week, there appear to have been limited payers of swaps causing the tightening.



Chairman LUCAS. Thank you.

Ms. Cetina, you are now recognized for 5 minutes for your oral remarks, please.

STATEMENT OF MS. JILL CETINA, EXECUTIVE PROFESSOR OF FINANCE, MAYS BUSINESS SCHOOL, TEXAS A&M UNIVERSITY

Ms. CETINA. Thank you. Good morning. I will begin by discussing three drivers of higher Treasury volatility after the April tariff announcement.

First, inflation expectations rose around the tariff announcement. For instance, the 1-year zero-coupon consumer price index (CPI) swap rose from about 2.3 percent in October to 3.6 percent after the tariff news. Treasury volatility increased because higher inflation expectations triggered a paradigm shift for some investment portfolio management. The common 60–40 equity bond portfolio begins to break down as a strategy when expected inflation exceeds 3 percent, replaced by alternative strategies that do not favor Treasuries.

Second, hedge funds have been trading the swap cash basis since the election. Simply put, hedge funds expect Treasuries will be excluded from banks' supplementary leverage ratios. Hedge funds expected banks to buy more Treasuries and that the spread between secured overnight financing rate (SOFR) swaps and comparable maturity Treasuries would rise. The unwind of this trade contributed to Treasury volatility as well.

Finally, the dollar weakened, and this is important because the dollar typically strengthens in risk-off events. Dollar weakness was suggestive of foreign capital outflows from the United States. Recent data from Japan indicates Japanese private and official holdings of Treasuries declined by about \$20 billion in early April.

Developments such as the sharp appreciation of the Taiwan dollar is also notable. These data suggest that Asian investors are rethinking their unhedged dollar exposures and perhaps dollar asset allocations more broadly and imply upward pressure on yields in U.S. fixed income markets will continue. Thus, the increase in Treasury market volatility on the one hand reflected investors' surprise to tariffs. On the other, these developments also reflect decades of economic policy undertaken with minimal consideration about their longer-run impact. These policies were enabled by trends such as disinflation from globalization, labor force growth, and low yields due to unconventional monetary policy. Trends that have been extrapolated that they will continue forever.

However, these forces are now in retreat, even as we face the problem that U.S. Government debt has simply grown too large. History suggests that high government debt is often solved through inflation, diminishing debt in real terms, but also eroding the currency's purchasing power. Movements in gold against the dollar over the last 2 years are close to meeting the IMF staff's definition of a currency crisis. Treasury market fragility and erosion of the U.S. dollar status are interlinked.

What then should or should not be done, and here I will differ from my colleagues. First, proposals for bank capital regulation are, in my view, a risky solution to Treasury market fragility. Eliminating bank capital requirements for U.S. Treasuries when

Treasurys are exhibiting heightened price volatility is inconsistent with sound risk management. Also, U.S. banks continue to have about \$500 billion in unrealized securities losses as of today. A prolonged bear steepening move in Treasurys is a plausible risk scenario that could have an even more negative impact on banks if Treasurys become SLR-exempt.

After World War II, U.S. Government debt to Gross Domestic Product (GDP) was roughly 100 percent. About 50 percent of U.S. banking system assets were invested in Treasurys at that time, and these positions did not require capital. So, maybe we should do this again. Simply put, we are not living in the 1950s. In the 1950s, Regulation Q prohibited U.S. banks from paying interest on checking accounts, so about 75 percent of bank funding had zero interest cost. Given interest rate deregulation in the 1980s due to the growth of money market mutual funds, banks must now compete for deposits, so today, it is impossible for banks to safely fund lots of long-dated government debt. If anything, high bank exposures to long-dated Treasurys combined with the absence of quantitative regulation and weak supervision of interest rate risk means that a sharp rise in Treasury yields can threaten bank solvency. This was the essence of Silicon Valley Bank.

Second, the Federal Reserve's use of unconventional monetary policy has both contributed to unsound fiscal policy and been destabilizing to the banking sector. For this reason, I do not support proposals to exclude banks' reserve balances at the Fed from the leverage ratio. Let us be clear that doing so permanently would remove all constraints on the size of the Fed's balance sheet.

Finally, we need to use the right tool. That is stabilizing fiscal policy, bringing the deficit down. I thank the committee for the opportunity to speak.

[Prepared statement of Ms. Cetina follows:]

Testimony for the House Committee on Financial Service's Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity

Jill Cetina, CFA

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May 15, 2025

I appreciate this opportunity to appear today before this Committee on the topic of examining Treasury market fragilities and preventive solutions. The Treasury market, US financial regulation and financial institutions have been a focus of mine through many roles over the last 20 plus years including as a financial economist in the US Treasury's Office of Debt Management, associate director for financial institutions policy at the Office of Financial Research, a vice president with responsibilities related both to bank supervision and monetary policy at the Federal Reserve Bank of Dallas, and associate managing director for US bank ratings at Moody's Investors Service.

Today I will focus on the Treasury market, the Federal Reserve's use of unconventional monetary policy and financial institution regulation, highlighting areas where I believe reforms both are and are not needed to strengthen Treasury market resilience and promote US financial stability.

I would like to make **three big picture points** today.

First, **bank deregulation is an ineffective solution to Treasury market fragility**. Indeed, reducing the amount of capital that banks hold against US Treasuries when Treasury market volatility is rising and stagflation is on the horizon is inconsistent with sound risk management and robust economic growth, instead increasing risks of a costly US financial stability event.

Second, **the Federal Reserve's use of unconventional monetary policy both has contributed to unsound fiscal policy and been destabilizing to the US banking sector**. The Federal Reserve, the Administration and Congress should recognize that the overuse of unconventional monetary policy unintentionally has contributed to a worsening of the nation's finances.

Finally, **we urgently need to run a more responsible fiscal policy – attempting to strengthen “Treasury market resilience” through bank deregulation and/or reliance on unconventional monetary policy are the wrong tools for the job**.

Turning to my first point – bank deregulation is an ineffective solution to Treasury market fragility. Both the Biden and Trump Administrations have been attracted to proposals to remove Treasuries from remaining large US banks' supplementary leverage ratios (SLRs) in the hope that such an action will promote greater “Treasury market resilience.”¹ Some in the US banking industry have also begun to advocate for changes to the risk-based capital surcharge for the most systemic US banks, or G-SIB surcharge, stating that it also is acting as a “unnecessary brake” on US banks' holdings of Treasuries. Finally, some advocate that the Tier 1 leverage ratio, which is a regulatory requirement that impacts all US banks, be reexamined, arguing that it “incorrectly” constrains bank investments in Treasuries.

¹ The 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) already removed Treasuries from the supplementary leverage ratios (SLRs) of the three large US custody banks.

Financial regulation needs to be consistent in its focus on promoting sound financial institution risk management. Eliminating bank capital requirements for US Treasuries when Treasuries are exhibiting heightened price volatility is inconsistent with sound risk management.

Unfortunately, the history of financial regulation includes periods of financial repression. What is financial repression? It is when governments implement regulatory policies to channel funds to themselves. Does financial repression sound farfetched? It is useful to remember how banks' existing risk-based capital standards came into being. Following the Great Depression, US bank supervisors focused on banks' capital to total asset ratio, effectively a leverage ratio. Following the end of World War II, risk-based capital standards were developed and facilitated US banks' substantial purchases of government securities which were granted a zero-risk weight, requiring no capital.

After World War II, US government debt to GDP was similar to current levels – roughly 100% of GDP. At the time, even though about 50% of US banking system assets were invested in US Treasuries, US banks' holdings of Treasuries securities were actually *not* a source of financial instability. So why not follow this approach today and encourage increased US banks' holdings of Treasuries securities? Simply put, we are no longer in the financial system of the 1950s.

For instance, in the 1950s, Federal Reserve Regulation Q prohibited US banks from paying interest on checking accounts/demand deposits. In 1950, these deposits were about 75 percent of US banks' total liabilities. That meant that 75 percent of US bank funding had zero interest cost. Ceilings also existed on the interest that US banks could pay on other deposit accounts. US banks were heavily invested in Treasuries and bank failures were negligible. In essence, Regulation Q permitted the US government to use banks to cheaply and safely fund the US government at negative real interest rates — the essence of financial repression. Given interest rate deregulation in the 1980s due to the growth of the US money market fund industry, today it is impossible to safely use US banks to fund the US government in such a manner again because banks need to compete for deposits. It also should be recognized that using banks to fund the Treasury market implies significantly less lending to US small businesses which are a key engine of US economic growth.

If anything, high bank exposure to Treasuries, combined with the absence of quantitative regulation of interest rate risk and weak supervision of interest rate risk, means that a sharp rise in Treasury yields can indeed pose a threat to US banks, as Silicon Valley Bank's failure in 2023 revealed. Indeed, there have been no US regulatory changes post-SVB with regards to interest rate risk. Rather, the contradiction of regional US banks receiving regulatory relief through 2018 bank regulatory "tailoring," but requiring systemic risk exceptions (SVB, First Republic) when they failed in 2023 continues.

It is plausible that some policymakers may have drawn the conclusion from the US bank failures in 2023 and in the elections that followed in 2024 that voters no longer care about banks. The 2024 election was a notable contrast to the 2008 election, when developments related to the unfolding Global Financial Crisis and US banks were influential in US electoral politics. A key difference in 2023 was the absence of a US banking-induced recession impacting both Main Street livelihoods and voters' 401k account values. Lingering Covid fiscal stimulus and continued expansionary fiscal policy helped contain the damage in parts of the US banking sector from spreading to the US economy more broadly. So will voters continue to disregard US bank regulatory policies going forward? The resounding answer to this question is "no." History teaches us that banking-led economic downturns tend to be associated with both deeper and longer recessions and that this matters to voters. If further financial deregulation and

supervisory mistakes are made in a more adverse macroeconomic environment like stagflation, a more severe US financial sector led downturn could ensue.

Turning to my second point, the Federal Reserve's use of unconventional monetary policy has both contributed to unsound fiscal policy and been destabilizing to the US banking sector. The Federal Reserve, the Administration and Congress should recognize that the overuse of unconventional monetary policy has unintentionally contributed to a worsening of the nation's finances. In this regard, I do not support excluding banks' reserve balances held at the Federal Reserve from banks' leverage ratios as this would effectively uncap unconventional monetary policy and allow for even larger Federal Reserve balance sheet expansions in the future.

Unconventional monetary policy, otherwise known as quantitative easing or QE, is destabilizing to the Treasury market and banks in several important ways:

QE reduces the term premia on long-dated US Treasuries, so implicitly it has encouraged excessive government budget deficits. QE changes the maturity profile of the consolidated US public sector's liabilities – meaning that the Fed's short-term liabilities are used to fund the Fed's long-dated asset purchases, exposing the consolidated public sector to losses which now exceed \$200 billion on the Fed's balance sheet. Shortening the maturity profile of the consolidated US public sector's debt stock implies that US public debt service metrics can worsen rapidly.

QE enables successively larger crisis interventions that can worsen the public sector balance sheet and also contribute to higher income inequality.

In practice, unconventional monetary policy has been destabilizing for US banks. Specifically, QE creates both reserve balances (a bank asset) and uninsured deposits (a bank liability) in the US banking sector. In the absence of strong US banking practices around interest rate risk, when interest rates are low during QE, some banks may over-invest these new deposits in fixed rate assets. Additionally, some banks will get rid of term funding when interest rates are low because they are "flush" with deposits – not recognizing that QE-related deposits could unwind quickly if the Fed needs to tighten. When QE is reversed through quantitative tightening, or QT, it is generally accompanied by higher interest rates so a bank's fixed rate assets could be devalued at the same time shrinkage in the Fed's balance sheet withdraws QE-related banking sector deposits.

Turning to my final point, we urgently need to run a more responsible fiscal policy. Bank deregulation and/or unconventional monetary policy are the wrong tools. When I was a financial economist in US Treasury debt management prior to the 2008 financial crisis, US government debt to GDP was about 60%. Fast forward to today and US government debt to GDP has swelled to ~100% – debt levels last seen around World War II. Over the intervening period, Democrats have passed laws permitting more spending; Republicans have passed laws granting lower taxes. Irrespective of who is controlling the White House and Congress, we have ended up with ever larger budget deficits and more US government debt. Indeed, running a budget deficit of 7% of GDP as we are doing today outside of a recession would have previously been unheard of.

As we know, the US government borrows in its own domestic currency. Therefore, in a real sense the government prints the money needed to fund its own deficit. What can go wrong? At least, three problems can emerge.

First, at higher and higher levels of US government debt to GDP, financial frictions begin to emerge in money creation getting recycled back to fund the US Treasury market. Specifically, the problem emerges when the growth in the US government debt stock is so rapid that it exceeds growth in the balance sheets of investors with both stable funding and willingness to hold Treasury securities. We are seeing foreign central banks and large asset managers intermediate smaller shares of the Treasury market. By contrast, hedge funds have become a larger and larger share of Treasury market intermediation, including via the basis trade which results from asset managers taking exposure to Treasury futures.² Recent developments with regards to tariffs may reduce foreign investor appetite – both foreign central banks and foreign private investors – for US Treasuries and other US financial assets. So reduced demand for US assets from foreign investors with stable balance sheets means more mark-to-market sensitive investors own Treasuries which, in turn, increases the sensitivity of the US Treasury market to shocks and the overall volatility of the Treasury market.

Second, higher volatility drives up US government financing costs and, over time, can be expected to crowd out corporate and household borrowers and to slow economic growth. The 10-year US Treasury term premium as estimated by Adrian, Crump and Moench's model had been falling for several decades, but inflected during Covid as US labor force growth slowed and now the term premium has begun to rise. The upward shift in the trend of the 10-year Treasury term premium is worrying given elevated US government debt levels. A danger is that it is underestimated how "low" US Treasury yields are right now – given that inflation still remains elevated and more volatile, US budget deficits are higher and the stock of Treasury debt to be financed so much larger. It is worth remembering where Treasury yields were through the 1990s as a risk scenario for US banks which continue to have as of Q1 2025 ~\$500 billion in unrealized securities losses at prevailing yield levels. A prolonged bear steepening move in the US Treasury market is a plausible risk scenario and one that would already negatively impact many US banks in light of their current securities and fixed rate loan exposures. In sum, encouraging US banks to hold more Treasury securities through bank deregulation may increase banking sector risks.

Third, history suggests that high government debt stocks are often solved through elevated inflation, eroding a currency's international purchasing power, but diminishing its debt stock in real terms. In their 2018 paper on modern banking crises, International Monetary Fund (IMF) staff define a currency crisis as meeting two conditions: a depreciation of at least 30% y/y; and a depreciation at least 10 percentage points higher than the prior year.³ Based on Fund staff's definition, movements in gold against the US dollar that began under the Biden Administration and have continued under the Trump Administration suggest the US dollar is not far from being in a currency crisis relative to gold. Foreign central bank reserve diversification into gold has been notable. Since 2011, seven US states also have passed legislation accepting gold and silver as legal tender. Indeed, Treasury market fragility and the erosion of the US dollar's status are interlinked.

² Barth, Kohn, Monin and Sokolinskiy ("Reaching for Duration and Leverage in the Treasury Market," Federal Reserve discussion paper, June 2024) show that when other fixed income securities (agency MBS, CLOs) become more attractive relative to Treasuries, asset managers sell Treasuries and buy the more attractive US fixed income assets which introduces tracking error — a widening gap between portfolio duration and the portfolio's benchmark duration. Asset managers establish long positions in Treasury futures to reduce this duration gap which, in turn, gives rise to the basis trade involving both asset managers and hedge funds.

³"Systemic Banking Crises Revisited," IMF staff working paper, Laeven and Valencia, 2018.

Delayed adjustment is always a more painful adjustment. The Trump Administration is seeking to raise revenue through tariffs and also narrow the US budget deficit through cuts to discretionary spending. According to a forecast released this week from Bloomberg Economics, US government debt is projected to reach 126% of GDP in 2034, down from a previous forecast of 132% thanks to forecast tariff revenue and discretionary spending cuts. While this is welcome progress, 126% government debt to GDP still would mark a significant increase from ~100% in 2024 and reflects Bloomberg's current estimates of planned tax cuts in H2 2025.

Winston Churchill once observed that "Americans can always be trusted to do the right thing, once all other possibilities have been exhausted." The combination of fifteen years of near zero interest rates, Social Security receipts funding other US borrowing, and elevated Federal Reserve remittances totaling roughly \$1 trillion to the Treasury from 2011-2022 due to QE together made the rise in US public sector indebtedness feel costless – until it wasn't. Significant structural economic changes such as deglobalization, aging demographics, and reduced immigration imply higher inflation and structurally higher interest rates ahead and require different policies. In light of these trends, it is imperative that Congress undertake a review of all of US non-discretionary spending, discretionary spending, and tax expenditures that disproportionately benefit high income Americans.

Since the Great Depression, the US and other advanced economies have moved from the gold standard to fiat money. Fiat money enabled more credit growth, financial wealth became more widespread, and use of leverage was democratized. The resulting surge in financialization of the US economy created public demand for ever bigger and more costly government and central bank ex-post financial crisis interventions, but also public, industry and even government resistance to ex-ante regulatory guardrails that might slow credit provision. These multi-decade dynamics have left us with significant fiscal, monetary and financial sector challenges. Additionally, this highly financialized system has disproportionately benefited some – mostly older generations of Americans who own more financial assets – relative to others – mostly younger generations who generally own fewer financial assets. The Administration aims to strengthen US national security through reindustrialization of national security relevant industries and reducing the high US government debt stock. I support these important objectives. But how will the burden of these economic adjustments be shared?

My key message is this – those who benefited more from our highly financialized system now need to make fiscal policy sacrifices for younger Americans to have opportunities, for the US to stabilize its demographics, and for our society to remain strong and successful. If younger Americans cannot afford to start families, US demographics cannot be stabilized. More dialogue is needed about how to create opportunities for younger Americans. Through this lens of fiscal policy needing to consider generational rebalancing, the draft House tax legislation that would increase the SALT deduction to \$30,000 and not increase taxes on those making more than \$2.5 million is disappointing and I hope will be reconsidered.

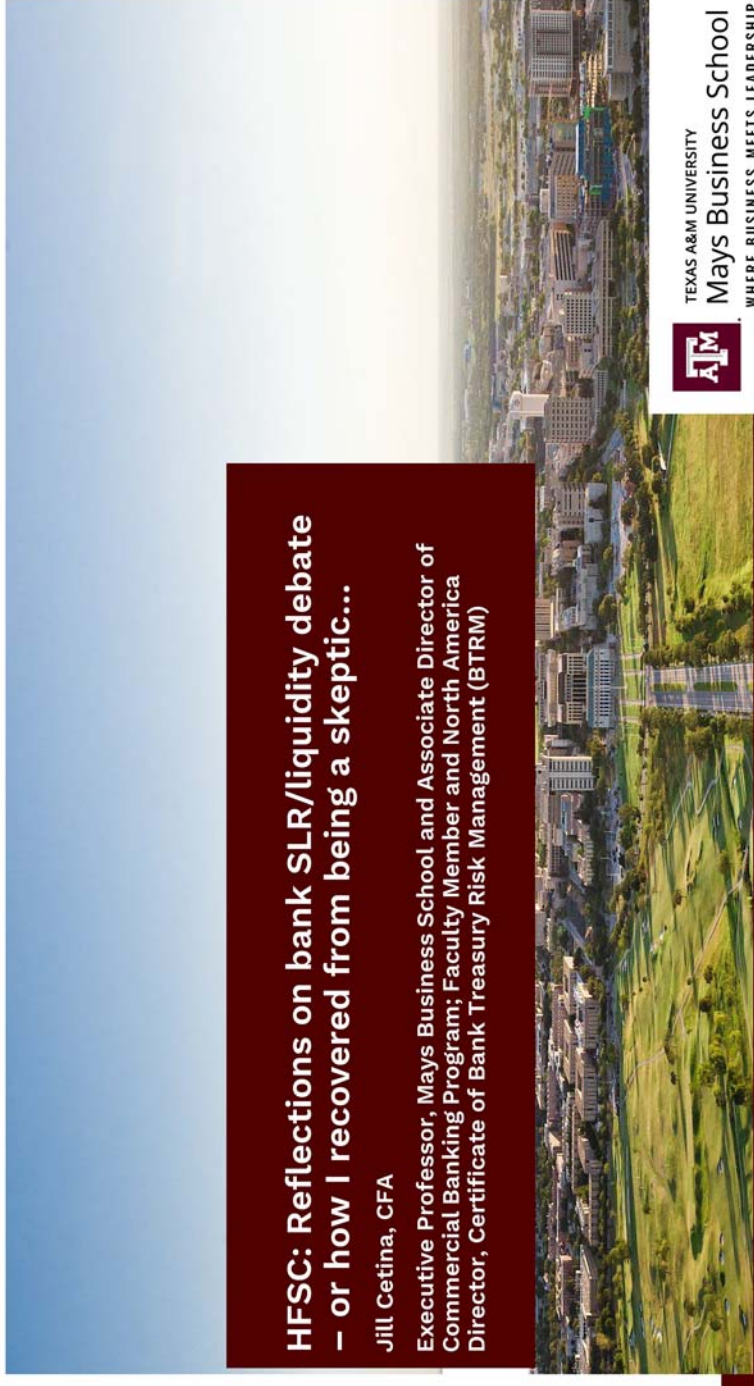
In closing, what can be done with regards to promoting US Treasury market stability?

In light of deglobalization, aging demographics, and reduced immigration, it is time to stop using inappropriate tools like bank SLR/G-SIB surcharge deregulation or unconventional monetary policy that attempt to "stabilize the Treasury market," but do nothing to address the important issue of sound fiscal policy. It is time to recognize both that greater fiscal discipline is urgently needed and that it is essential that US fiscal policy be structured with an eye to making life more affordable for younger Americans so that US demographics, labor force growth, and, indeed, our country's future can be stabilized.

HFSC: Reflections on bank SLR/liquidity debate – or how I recovered from being a skeptic...

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SLR and LCR – I started off a bit of skeptic



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Do higher capital standards always reduce bank risk? The impact of the Basel leverage ratio on the U.S. triparty repo market ☆

Meraj Allahrakha^a, Jill Cetina^a, Benjamin Munyan^{a, b}

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The Difficult Business of Measuring Banks' Liquidity: Understanding the Liquidity Coverage Ratio

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Capital centric view (policy consensus) vs ALM integrated view (reality)

- High levels of risk-based capital solve all problems.
- Bank runs happen when asset values are uncertain and therefore depositors perceive solvency is at risk.
- Main concern is adequate quantity and quality of risk-based capital.
- If the bank is adequately capitalized, liquidity problems can be solved through central bank lending and are of limited relevance.
- Liquidity is the ability to ensure the availability of funds to meet a bank's contractual and contingent commitments at a reasonable price at all times.
- 1) Liquidity, 2) interest rate risk and 3) profitability are inextricably interlinked and cannot be thought about separately.
- Profitability is a bank's first buffer against loss and, along with CECL and capital, part of the three legs of the stool of a bank's loss absorbency.
- A bank can be "well capitalized", but NPV negative/weak economic capital.

Fed liquidity does not work in all macroeconomic environments; it works poorly when supply shocks/interest rate shocks occur

Implications of excess pursuit of net interest income (NII) on subsequent profitability, economic capital, liquidity and asset growth	
	Yield curve positively sloped followed by elevated inflation
Excessive short-term focus on NII leads to ...	Significant borrow short/lend long fixed rate
Initial impact on profitability but big EVE risk	Positive – because short-run NII boost from long-dated fixed rate assets
Economic capital impact after shock	Negative if rates rise.
Liquidity impact	Negative if rates rise.
Asset growth/repricing	Negative – weak asset growth and slow repricing if rates rise.
Central bank lending as stabilizer	Negative – absence of rate cuts so central bank funding costly vs deposits.

- Concomitant QT with interest rates still high
 - Reduces central bank reserves/bank liquidity
 - Pressures bank deposits as government securities that runoff central bank balance sheet are refinanced by non-bank financial institutions – drawing down bank deposits.

Central bank liquidity injections are costly

- In 2008 Fed liquidity injections into US banks contributed to the launch of unconventional monetary policy.
- Unconventional monetary policy is destabilizing in three ways.
 - In practice, QE creates both reserve balances and uninsured deposits in the banking sector.
 - QE reduces term premia so implicitly limits bond market discipline on government budget deficits.
 - QE enables successively larger crisis interventions that ultimately worsen the public sector balance sheet.
- First Republic was economically insolvent. Fed lending to First Republic enabled deposit flight and transferred losses from Fed to FDIC and ultimately other US banks through DIF assessment.
- Proposals for required liquidity related to uninsured deposits have receded. LCR recognizes that liquidity risk is broader than uninsured deposits.

IRB-BB and LCR would have helped/supervision is not enough

- Feldberg, Cetina, Mott (2025)
 - IRB-BB outlier test would have identified SVB as a risk 10 quarters prior to failure.
 - LCR would have flagged SVB four quarters prior to failure.
 - Regulatory tailoring contributed to 2023 bank failures, but no regulatory changes post SVB.
- IMF staff pointed out in its last two US financial sector assessments (2015 and 2020) that the US banking system lacked adequate quantitative regulation of IRR-BB.
- “Tracing Bank Runs in Real Time” (2024) makes use of data uniquely available to Fed staff -- 22 US banks had runs following SVB’s failure.
 - But uses asset size as control as opposed to relevant US bank regulatory cutoffs (Cat I-IV banks) for the LCR and inclusion of AOCI/unrealized available-for-sale securities gains/losses in reg capital.

Table II. Partial Correlation Matrix CAMELS and CAMELS Component Ratings

	CAMELS	Cap	AQ	Man	Earn	Liq	Sens
CAMELS	1.00						
Cap	0.27	1.00					
AQ	0.32	0.18	1.00				
Man	0.65	-0.07	0.07	1.00			
Earn	0.24	0.18	-0.01	0.04	1.00		
Liq	0.09	0.24	0.07	0.02	0.02	1.00	
Sens	0.11	0.01	-0.05	0.08	0.12	0.16	1.00

- Gaul and Jones (2021) – 1984-2020 S sub-component is weakly correlated with others, suggesting S rating may capture new information.
- Can approximate the r2 of each CAMELS component to the overall composite CAMELS rating. For the S rating, this calculation implies that only ~1% of the variation in a bank’s CAMELS composite rating is attributable to the variation in a bank’s S rating. This is the second lowest individual CAMELS sub-component contribution with L being the lowest.
- Gopalan and Granja (2024) have access to more current US bank supervisory exam data (Q4 2021 to Q1 2023). Their work shows no relation between the frequency of downgrade of a bank’s “S” or “L” rating and examined banks’ interest rate exposures prior to Q2 2022 - when the Federal Reserve began to raise interest rates.

Remove Treasuries from SLR – no, we are not in 1950

- Proposals to remove Treasuries from SLR, “tweak” G-SIB surcharge.
- In 1948-1950 US banks financed large quantities of US government securities when debt/GDP was elevated – we are not in 1950s.
- Reg Q restrictions capping deposit rates mostly eliminated.
- Risk creating bank/sovereign nexus.
- Start of classic government crowding out private sector?

Table 19. ASSETS AND LIABILITIES OF ALL BANKS IN THE UNITED STATES AND POSSESSIONS, DECEMBER, 1950, 1949, AND 1945

Asset, liability, or capital account item	Amount (in millions)			Percentage distribution		
	Dec. 30, 1950	Dec. 31, 1949	Dec. 31, 1945	Dec. 30, 1950	Dec. 31, 1949	Dec. 31, 1945
Total assets	\$192,241	\$180,043	\$175,203	100.0%	100.0%	100.0%
Cash and funds due from banks.....	41,236	36,576	35,585	21.4	20.4	20.0
United States Government obligations.....	73,188	78,754	101,822	38.1	43.7	57.1
Obligations of States and subdivisions.....	8,249	6,657	4,064	4.3	3.7	2.3
Other securities.....	6,568	6,025	4,531	3.4	3.3	2.5
Loans and discounts--net.....	60,711	49,828	30,473	31.6	27.7	17.1
Miscellaneous assets.....	2,289	2,103	1,728	1.2	1.2	1.0
Total liabilities and capital accounts	\$192,241	\$180,043	\$175,203	100.0%	100.0%	100.0%
Total deposits.....	176,120	165,244	166,474	91.6	91.8	93.4
Miscellaneous liabilities.....	2,205	1,633	1,203	1.2	.9	.7
Total capital accounts.....	13,916	13,166	10,526	7.2	7.3	5.9
Number of banks.....	14,693	14,736	14,725			

¹ Asset and liability data were not available for 27 banks on December 30, 1950, 31 banks on December 31, 1949, and 104 banks on December 31, 1945.

Detailed data for 1950: See Table 105, pp 232-33.

— Stagflation coming – bad for banks, but response...



- Stagflation is most stressful macroeconomic scenario for banks – it stresses capital, liquidity and interest rate risk simultaneously.
- But many US banks are returning capital (share buybacks), bank deregulation on the table and no effort to improve liquidity or quantify interest rate risk.
- Are US banks better prepared for stress of stagflation? Unlikely
- Banks need to stress test to stagflation and 6% 10-year Treasury yield.

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Chairman LUCAS. Thank you.

We will now turn to member questions, and the chair recognizes himself for 5 minutes for questioning.

Mr. Jersey, and then I would like to get Mr. Wuerffel's thoughts on this also, can you describe the functioning of the market during the high volatility last month? How were markets able to accommodate both high volume with low liquidity?

Mr. JERSEY. The answer is it did function. The market price moved in order to find where demand met—what was met. In a period, for example, overnight, if we look at April 7th in particular, where Asian investors came in after hearing some news overnight, decided to sell Treasury securities, but at that point, remember, there is a very limited pool of liquidity during those hours, right, so some of the volatility was more from a timing issue. If you just look at how volatile the market was during that 2-hour period from 10 p.m. our time to midnight, once you got to 1 when Frankfurt opened and Paris opened and London opened, ultimately, you had a bigger pool of liquidity, and prices rebounded somewhat because you were able to find another pool of liquidity.

The challenge we have looking at the Treasury market on a daily basis in a market that basically does not close is that you have to appreciate when those market moves occur, and is that really a clearing price during that moment, or is that overall clearing price for the entire global market? I think that we experienced that during those 3 or 4 days in April.

Chairman LUCAS. Mr. Wuerffel.

Mr. WUERFFEL. Thank you for the question. In April, what I think we saw was that there was uncertainty around trade policy, and that led into uncertainty about some fundamental factors that drive interest rates in the Treasury market, including the path of interest rates, the inflation, the growth of the Treasury market and its supply.

What we see in the Treasury market, it is the safest, most liquid market in the world. It trades about \$1 trillion a day in purchase and sale activity and about \$5.5 trillion dollars of repo financing activity a day, so it is able to withstand high degrees of volatility. What we saw in April, that the indicators of market functioning, things like bid-ask spreads and other indicators, did deteriorate rapidly. However, they recovered after some of the uncertainty was resolved. I think what I see in April is that it is sort of a cautionary tale, a reminder that we need to focus on the safety and liquidity of the structure of the Treasury market to make it resilient going forward.

Chairman LUCAS. Continuing with you, Mr. Wuerffel, you have testified that the SEC's clearing rule could improve market liquidity and resilience. Can you talk about the importance of getting implementation right, not just done? We only realize the benefits of a rule like this if all the regulators are rolling in the same direction, would you not say?

Mr. WUERFFEL. That is an excellent question, and I would agree that the central clearing rule represents the most significant change to Treasury market structure in decades. We think it is important because it will reduce counterparty credit risk and financial stability risk, but getting it right is paramount. The extension

of the timelines that the SEC announced recently have been helpful.

I think the market will be able to use that additional time to implement the changes, the necessary operations and legal documents. We think a fair and level playing field implementation of central clearing is important, and that is achievable, we think, in the timeframes given.

Chairman LUCAS. Dr. Duffie, last week I spoke with Secretary Bessent on these issues, and he testified that recent auctions had weaker investor demand. He suggested capital requirements may be playing a role there. What are the regulatory constraints on market participants' balance sheets and should regulators look at recalibrating the SLR and the enhanced supplementary leverage ratio (ESLR) to encourage intermediation in the Treasury market?

Mr. DUFFIE. Chairman Lucas, I agree with Secretary Bessent that capital plays a role. However, well-capitalized dealers are best positioned to bid aggressively in the auction, so capital constraints matter, but lowering capital altogether is not a good idea. The distortionary effects of the SLR, on the other hand, should be corrected. There is no reason to penalize, for example, Federal Reserve deposits because of any sort of risk or illiquidity. On the contrary, they are perfectly liquid. So improving the SLR but making sure that banks remain very well capitalized should be the priority both for Treasury market resilience and also for financial stability generally.

Chairman LUCAS. The fundamental challenge, I think, is this: The market's ability to intermediate is not commensurate with the tremendous growth in the issuances many of you have touched on. We have to come up with a way to address that intermediate capacity moving forward.

With that, my time is about to expire. The chair recognizes the Ranking Member of the Task Force, Mr. Vargas, for 5 minutes of questions.

Mr. VARGAS. Thank you very much, Mr. Chairman. Again, I want to thank the panel for being here.

Ms. Cetina, you heard the comments that were made by Mr. Wuerffel regarding the central clearing rule. Do you have any comments to what he said, any disagreements?

Ms. CETINA. No. I think central clearing is foundationally important and can be helpful to promoting greater stability in the Treasury market and getting to better controls around counterparty credit risk. I do think it is important that central clearing of Treasuries be implemented, but if there is a need for a bit more, I will say, runway to make that be an effective rollout, that is sensible. I think what would be unfortunate is if somehow that were to just not happen, which I do not perceive was Mr. Wuerffel's position.

Mr. VARGAS. Okay. So there does seem to be some agreement there then?

Ms. CETINA. Yes.

Mr. VARGAS. Any disagreement between any of the rest of the—

Mr. JERSEY. No, I wholeheartedly agree. In fact, if we go back to the 2007 to 2009 financial crisis, if we had central clearing of things like credit derivatives at the time, which we do now, the vol-

atility probably would have been most mitigated very significantly. Central clearing, I think, is a way to have a public good and be able to mutualize the risk of the clearing of the market, and especially Treasurys, because they do not have credit risk, so they should be something that we should be able to easily clear.

Mr. VARGAS. Dr. Duffie.

Mr. DUFFIE. I completely agree. Increasing central clearing should remain one of the highest priorities of Treasury market regulators. It is crucial for Treasury market resilience and for financial stability.

Mr. VARGAS. Okay. Now, I do want to ask now because Mr. Jersey, you said this, the amount of Treasurys outstanding was an issue. In fact, assume that today the national debt is \$36,215,000,000,000, and it is going up every moment.

If my Republican friends are able to pass the “big, beautiful bill,” will that number next year be higher or lower? Will it be more than \$36 trillion or less than \$36 trillion?

Mr. JERSEY. I think, ultimately, in order to cut our deficit forecast—

Mr. VARGAS. That number?

Mr. JERSEY. Our deficit forecast is for \$1.8 trillion deficit this year and next year, so—

Mr. VARGAS. Even if they pass their bill?

Mr. JERSEY. Correct.

Mr. VARGAS. Ms. Cetina, do you agree with that?

Ms. CETINA. I am sorry. I do not have a particular forecast, but my understanding is that we are looking at deficits widening under what is being discussed currently in this chamber of Congress and that would increase financing needs. So, again, going back to my fundamental position, which is that we need to do more to bring the deficit under control. I think that this is the root cause of the issues that we are discussing in this committee today, which is the fact that we have not brought the budget deficit onto a glidepath down.

Mr. VARGAS. In fact, could you talk a little bit about the problem of stagflation? If we get into stagflation because of the increase in our debt and the situation that we will find ourselves in if this “big, beautiful bill” passes, and tariffs and all the other chaos that we see.

Ms. CETINA. I would like to make the point that stagflation, to me—the risks that it poses to the U.S. banking sector, I think, perhaps may be underappreciated. The reason that I say this is that stagflation activates credit problems at banks, liquidity risk, and interest rate risk all simultaneously. We have not experienced this in the U.S. banking sector since the 1980s. So any bank that is even trying to make I will call it a strong effort to model what this might mean, a macroeconomic scenario like this for themselves, faces significant data limitations and challenges. So I do think this is a very challenging environment that banks may face.

The reason that I am raising this in response to your question is that banking crises, the median banking crisis, according to International Monetary Fund (IMF) research, adds about 34 percentage points in terms of debt to GDP when they occur. So from my vantage point, avoiding a banking crisis is highly important to

not seeing the Treasury market size expand massively because of a financial stability event, and it is something that I think—

Mr. VARGAS. I have just 15 seconds left. I would just say that, again, if we are going to tame the deficit and the debt, we cannot continue down this, giving huge tax cuts to wealthy people. It just is not going to work.

Thank you. With that, I yield back.

Chairman LUCAS. The gentleman yields back.

The chair now turns to the gentleman from Arkansas, Mr. Hill, chairman of the full committee, to be recognized for 5 minutes. Mr. Chairman.

Chairman HILL. Thank you, Mr. Lucas. We are all concerned about the long-term unsustainable budget deficits, 7 percent of GDP. Let us be clear, the crisis of 9/11, the financial crisis of 1907 to 1909, and the pandemic produced extraordinary reactions from the U.S. Government spending, period, full stop, paid for by borrowing money to fund those crises.

It is a bipartisan issue and to treat it in a partisan way does not make any difference to this hearing because the fact of the matter is we have that situation. If it was such a crisis, then perhaps President Biden and then-Speaker Nancy Pelosi would not have authorized \$6 trillion of new spending on top of a \$2 trillion deficit that we were running anyway due to those crises.

Let me start with you, Dr. Cetina. I really enjoyed your testimony. Very, very interesting. Comment one, I took your point about you are not a quantitative easing (QE) fan from your background. I am not either. I thought it was a big mistake by previous Feds. Should we pay interest on reserves of the Fed?

Ms. CETINA. I think that to do so is basically equivalent to taxing the banking sector. It becomes a “heads, you lose; tails, you lose” proposition for the banking sector if we do not pay any interest. The reason that I say that is that when policy rates were at zero, this was a drag on banking sector performance. Then if when rates are higher, we also do not pay interest, it is a drag on banking sector performance.

I do believe—and I have published research when I was associate managing director at Moody’s, it was the first piece of research I published when I joined Moody’s, that unconventional monetary policy is credit-negative for U.S. banks. I really think this needs more discussion. Viral Acharya and others have published on this.

Chairman HILL. It is where monetary policy links with our discussion today, and it is why Chairman Lucas and Ranking Member Vargas have such an important task. I think to sort through that is one of the top issues.

On central clearing, I see a lot of unanimity on that point today and I think we have seen the benefits in the past, and we see it now in the Treasury market. Is central clearing 7 days a week, 24 hours a day, Mr. Wuerffel?

Mr. WUERFFEL. Thank you for the question. Central clearing is not 7 days a week, 24 hours a day.

Chairman HILL. Should it be?

Mr. WUERFFEL. I—

Chairman HILL. The biggest, most liquid market in the world, generating \$2 trillion of new issuance every year?

Mr. WUERFFEL. I think one of the really interesting things about the Treasury market is its evolution over time and moving into a world where you can settle a Treasury security, you can get cash for a Treasury security in smaller increments of time anywhere in the world at any time of day would be a real advancement in the Treasury market. I think there is a lot of operational and mechanical steps that are needed to get to that state.

Chairman HILL. Dr. Duffie, you talked about expanding capacity in the market. That is, again, a theme of this Task Force. What does that mean to you? How do you see expanding capacity in the Treasury market?

Mr. DUFFIE. Thank you, Mr. Hill. On a normal day, the Treasury market deserves the label of being the deepest and most liquid market in the world. It has plenty of capacity. It is really the surge capacity that is in question. In March 2020 and to a lesser extent, last month, we saw that when investors around the world suddenly want to sell a lot of Treasuries, and volatility is very high, the capacity of the market is stressed. It is exactly at those moments that investors who had been holding Treasuries in order to use them in a stressed market are having difficulty selling them.

To me, increasing the capacity means increasing the peak or surge capacity of the market by expanding the ability of dealers to absorb customer positions, and if necessary, by trading through all-to-all platforms where you do not necessarily have to take up space on a dealer balance sheet.

Chairman HILL. Yes, that is helpful. Thanks for that. Should the Fed have a Treasury-only balance sheet, ideally?

Mr. DUFFIE. That is my view. That reduces—

Chairman HILL. Does the panel share that view? You have worked at the Fed. Jill, what is your view on that?

I am talking about long term, like not in a period of crisis where they might choose another asset class. Should it be Treasuries in the long run, though?

Ms. CETINA. My concern is that the Fed is so large that when the Fed disfavors agency MBS, it creates potentially richness in the agency MBS market that may actually draw private investors into agency MBS and away from Treasuries. The Fed is not a small actor in the bond market. It likes to pretend that it is, but that is not the case.

Chairman HILL. Thank you. I yield back. I appreciate the chairman's time.

Chairman LUCAS. The gentleman yields back.

The chair now recognizes the gentleman from California, Mr. Sherman, who is also a Ranking Member of the Subcommittee on Capital Markets, for 5 minutes.

Mr. SHERMAN. We take some solace that we have been here with this large of a debt right after World War II, but we should not because that debt could be paid off without increasing taxes or decreasing domestic spending because we ended World War II, and we brought the boys home. So we have never faced a crisis like this. We have a national debt that would embarrass Argentina. We have gotten away with it for a long time, but now, we are reaching points that even the United States may not be able to handle. We have to deal with the size of the debt, the fact that crypto has said

that it wants to take some or all of the benefits of being the world's reserve currency away from us.

We have to deal with the insanity of our current President. Liberation Day, no Liberation Day, chaos is costly. We have to deal with the effect of inflation, and of course the Peterson Institute said that Trump's policies would increase inflation over the next several years by 4 to 7 1/2 points. We have to deal with the international effect of the lack of the rule of law, increasing obvious corruption and the attacks on the Fed, all of which undermine the image of the United States and the dollar.

We are paying an awful lot. The debt compounds on itself because we have to pay interest on the debt, which is now going to be the largest thing we spend money on, or we monetize the debt. I think we ought to be looking more at that, not because it is a solution, but because it may be less painful than paying interest on the debt.

The chair of the full committee pointed out that we had \$6 trillion of COVID spending. I should remind him that 70 percent of that was signed by Donald Trump, whereas I do not know a Democrat who voted for the 2017 tax cut, and I do not know a Democrat that is going to vote for the tax cuts they are considering now.

I want to thank Ms. Cetina for pointing out the importance of interest rate risk to our banks. That is what doomed Silicon Valley Bank, and the idea of treating a long-term instrument, Federal or otherwise, as risk-free ignores the fact that interest rates can go up and down.

Let us see. Believe it or not, I do have some questions in here somewhere. Okay. Three years ago, I was able to pass the LIBOR Act, which dealt with \$16 trillion of adjustable rate instruments, where, had we not passed that act, the debtor and creditor would not know how much was to be paid because the index was no longer published.

Mr. Wuerffel, we have now changed from LIBOR to SOFR. How's that going?

Mr. WUERFFEL. Thank you for the question. I think the transition away from LIBOR has been a significant success. That is after many years of work, and I spent many years working on this problem at the Federal Reserve. We have seen a quite smooth transition away. That took a lot of work to make sure that the markets could successfully implement the change and then come out of it functioning smoothly.

I think it is perhaps a useful parallel to some of the opportunities that the public sector has to support market change in the Treasury market, where adjustments to improve market safety like central clearing or targeted adjustments to the leverage ratio to improve intermediation or the ability to promote more liquidity in the market could be useful.

Mr. SHERMAN. I want to squeeze in one more question. We have a supplemental leverage ratio, which is the key factor in banks determining their policies, and it seems to discriminate against U.S. Treasuries by regarding them as no more risk-free than bonds issued by private players in the market. The leverage capital requirements are insensitive to the fact that the Treasuries are risk-free as far as credit risk.

Mr. Wuerffel, could you talk us through what happens in the broader financial markets if U.S. Treasury markets become less liquid, perhaps as a result of the large banks feeling that they cannot hold U.S. Treasuries in the quantities they are used to?

Mr. WUERFFEL. Thank you for that question. The Treasury market is the safest, most liquid market in the world, and it really hinges on those two characteristics of a Treasury market. These are those foundational characteristics all the way back to Alexander Hamilton. It is a safe instrument to conduct a trade in, and you are guaranteed the payment by the government. It is also a liquid instrument because it can change hands.

So, I think if you undermine either of those characteristics of a Treasury security, you have a risk of undermining confidence in it as an asset class. It is a huge asset to the United States as a country and to taxpayers that we have this market that allows us to finance the government at low cost.

Chairman LUCAS. The gentleman's time has expired.

The chair now recognizes the gentleman from Michigan, Mr. Huizenga, who is also vice chairman of the full committee, for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate your time and everybody being here today. This is incredibly important that we examine this.

Dr. Duffie, let me start with you if I could, please. You had mentioned this, I think, very briefly, the all-to-all trading in an answer to Chair Hill, and you talked about the emergence of this and how they are improved by greater use of central clearing, as we have talked about pretty extensively, and more post-trade transparency. You noted that regulators should push further in these directions.

You did say in your testimony, encouraged—and I think in parentheses “although not mandate.” So, I am curious as to the word choice and definition on that, first of all. Can you help the committee understand how you believe this can be accomplished? Do you believe investors will get better execution, increased competition by having more of this information?

Mr. DUFFIE. Yes, Mr. Huizenga. It can be accomplished by some of the measures that I discussed in my testimony like more central clearing, more price transparency, and eliminating some practices that make it difficult for investors to trade with competition among different counterparties. By introducing all-to-all trade, investors can compete with each other for the opportunity to buy and to sell. They do not need to rely exclusively on a dealer to do that. They do not need to impinge on a dealer balance sheet to execute a trade. Markets will become more liquid because of improved competition and market capacity.

How is that more transparent, though? It is more transparent in part because exchange trading or all-to-all trade provides more immediate price transparency and more information on market depth.

Mr. HUIZENGA. All right. Will there be greater efficiencies, more liquidity? I mean, we talked about transparency, but is there going to be efficiencies or liquidity added if this is adopted?

Mr. DUFFIE. Yes, definitely. Just as we see today in the futures market where we did not have problems with this functionality, you get greater efficiency because you have more investors that can

trade directly and immediately with each other, not necessarily having to go through a dealer's balance sheet and waiting for the dealer to then on-sell the Treasuries to another investor.

That is not to say that dealers would not be part of the all-to-all trade. They would be the most important contributor, and many investors would still want to trade directly with the dealer.

Mr. HUIZENG. These would not be in any kind of dark pool. It would be out—would there be some, again—with the central clearing, I assume that is how this would have that gained transparency?

Mr. DUFFIE. That would be the ideal, but of course it would be up to regulators how to design the infrastructure and the regulations around that. As you mentioned, I do not think regulators should mandate that. An overly prescriptive regulation that forces all-to-all trade could have unintended consequences.

Mr. HUIZENG. Okay. Last week, Roberto Perli, who manages the Fed's roughly \$6 billion securities portfolio, said that one factor that contributed to the sharp rise in yields was due to the abrupt unwinding of the swap spread trade, a trade that both Mr. Jersey and Mr. Wuerffel had highlighted in their testimonies. Mr. Jersey, could you briefly explain what the swap spread trade is and its role in April's volatility?

Mr. JERSEY. Sure. First, let me say that one of the reasons why Treasury securities are so liquid, even though there is a large amount outstanding, is that we have an entire infrastructure of derivative instruments that investors and dealers and others can use to hedge them, and swaps and interest rate swaps are just one of them.

Interest rate swaps right now are based on SOFR, on the secured overnight financing rate, and investors, when they get into a swap spread trade and the trades that unwound a little bit in early April were long Treasury securities in the anticipation that the SLR would be amended to exclude Treasuries, so people purchased Treasury securities and they paid or sold interest rate risk via swaps. When there was some doubt as to what the extent of the SLR would be or those shifts, you saw an unwind of those trades.

To market function standpoint—and since we are talking about market function today, I would note that the repo market and other funding sources and other funding parts of those trades all functioned very smoothly, even though there was very significant movement in the price of both of those instruments, both Treasuries and interest rate swaps.

Mr. HUIZENG. I am out of time, but I was going to ask could the SLR reforms have prevented or mitigated the impact of the Treasury markets that stem from the unwinding of the swap spread trade? I am out of time. We will submit that question for writing, though, because I think that would be—

Chairman LUCAS. The gentleman's time has expired.

The gentleman from Illinois, Mr. Casten is recognized for 5 minutes.

Mr. CASTEN. Thank you, Mr. Lucas. Thanks to our witnesses.

As my colleagues know, I spend a lot of time thinking about climate change and trying to deal with it here. My sort of long-term concern is that our challenge dealing with climate change in this

country is not because the physics is not understood, it is because it has become political to acknowledge the physics. So, the rest of the world looks at the United States and says when Democrats are in, you will deal with this, but when Republicans are in, you will not, and so we cannot treat the United States as a reliable partner.

My fear in this hearing is that we are at a point where monetary policy is falling into that same bucket of things that should not be partisan but are. We have a naked emperor who has fallen in love with 1890s fiscal policy. Let us jack up tariffs, let us go to hard money, let us have light touch regulation. We know from the 1890s that leads to 1890s style panics, but we cannot talk about that. We can just talk about how nice the emperor's clothes are.

Now we are finding ourselves with this scenario, and I think, Ms. Cetina, you mentioned, it has been an unprecedented month, as all you know. We had a collapse in U.S. equity markets, stapled to a collapse in Treasuries. That is not supposed to happen.

I guess I would like to start with you, Mr. Wuerffel, because last month, BNY Mellon said, "The haven status of Treasury securities is increasingly in question," as foreign investors have been selling more Treasuries. Is that still ongoing? How concerned are you that is a structural trend going on in our market right now?

Mr. WUERFFEL. Thank you for that question. If you look at some of the longer-term trends, what we see in the Treasury market, for example, in the last decade, is that foreign holdings of the Treasury market have gone down as a share of the Treasury market size from about 50 to 30 percent over that 10-year period. Then we also see ebbs and flows in foreign participation in the Treasury market, and we did see some flows.

Mr. CASTEN. I just challenge that because like over the—I agree with those 10-year trends——

Mr. WUERFFEL. Yes.

Mr. CASTEN [continuing]. but we also saw foreigners like the Japanese, like the Europeans, move from investing in the U.S. economy via Treasuries to investing in the U.S. economy via equities. I do not think we have a 10-year trend of people selling off equities and getting out of Treasuries, right?

Mr. WUERFFEL. Yes, what I would say, in the Treasury market, as you have said, you have seen a change in the composition of Treasury market ownership, but just as some players have pulled a smaller share, other players—for example, money funds, mutual funds—have grown their share of the Treasury market. I think the important thing is making sure it is a marketplace with a broad and deep buyer base——

Mr. CASTEN. Look, I understand what you are saying. You are also making me only more scared because, from your perspective, you do not want to annoy these folks over on the other side of the aisle by acknowledging what we know to be true. Bridgewater just said that foreign investors are placing a risk premium on U.S. assets, and there is a "slow bleed" of support out of U.S. markets, not just Treasuries.

Bank of America, as you mentioned, Ms. Cetina, saw a \$8.9 billion outflow into Japanese and European stocks at the end of April. If you had perfect foresight, you would have moved your portfolio into European equities on January 20th, and yet on January 19th,

everybody was saying that the U.S. economy was the envy of the world, right?

So, I guess, Professor Cetina, can you help us understand, if we have this exit from Treasuries, that is going to lead to higher Treasury rates, right? It is going to lead to a weakened dollar, which means a more expensive cost for us to pay off our debt, and ultimately, some long-term threat to the reserve currency of the U.S. dollar. How many of those changes are fixed once you put someone economically literate who is not beholden to Peter Navarro in the White House, and how many of those changes are irreversible?

Ms. CETINA. I guess how I would respond to this question is that I think we have foreign investment that is quite broad in U.S. financial markets, and I think it is very important that U.S. economic policymakers on both sides of the aisle recognize that we have what is called the net international investment position of the United States, which is the accumulation of foreign portfolio investment, which is the counterpart to our trade deficit, which amounts to almost 80 percent of U.S. GDP.

So, we need to pay attention, for lack of a better word, to our relationships with other countries, how we communicate with them. This is very important. There are less important investors in Treasury markets but important investors in our investment-grade corporate bond market, in the equity market, as you pointed out. To the extent that they decide that they want to hedge dollar holdings more, hold fewer dollar holdings, then basically I think what we are looking at is, in general equilibrium, higher costs of capital for the United States.

Mr. CASTEN. I could talk much more, but I am out of time. Thank you, and I yield back.

Chairman LUCAS. The gentleman yields back.

The gentleman from Kentucky, Mr. Barr, who is also Chairman of the Subcommittee on Financial Institutions, is now recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. I suppose we could talk about fiscal sustainability in the context of the Laffer curve and whether or not a massive tax increase on the American people would stifle economic growth to the point where it would worsen, not help our deficit and debt picture.

I am going to resist the temptation to launch into that debate, but let me just ask any of you all, based on Professor Cetina's point about the importance of fiscal responsibility, sustainability of our debt picture, I want to know what the tipping point is. Can any of you help the committee understand what is the tipping point? So we have a \$36 trillion national debt. That is 127 percent of our GDP. There are other countries, a few handful of countries with higher debt-to-GDP ratios. Japan comes to mind, 250 percent, among the highest in the world. When do the bond vigilantes come? Does anybody have an opinion about that, where people start demanding much higher yield because it is a riskier asset? It is the safest, deepest liquid market in the world, but when does that cease to be? Can anyone offer an opinion on that?

Mr. JERSEY. So, Congressman, I have spent quite a lot of hours studying this exact issue, trying to find that number, that magic number of percent of GDP or however else you want to couch it,

but our opinion within our strategy group at Bloomberg Intelligence is we are very close to that level where, not that you will just see a massive sell-off in Treasuries, but that Treasury sell-offs will become somewhat more pronounced and rallies will be shallower.

So, the Treasury market at this point—and I think given the fact that we are the reserve currency, we do have a very broad ownership base and buyer base and reasons for people to own it, will continue to be cyclical with interest rates or with the economy, but they are not just going to randomly sell off to, say, 10 percent. We are not an emerging market. Until the reserve currency changes to something else, the U.S. Treasury market, I think, will remain deep and liquid.

Mr. BARR. Professor.

Ms. CETINA. Yes, I just wanted to make a point. There is a beautiful piece of research from the St. Louis Fed called “What About Japan?” I highly recommend people on this committee read it.

Basically, what they do is they nicely debunk the point that Japan has higher government debt to GDP; therefore, we should find solace in it. They point out that the Japanese have significant foreign asset holdings, which tend to, when you net those down, ameliorate their debt-to-GDP level. I just highly recommend it because “What About Japan?” is often invoked to say, let us continue on our—

Mr. BARR. Thanks. One final editorial comment is, look, growth will not solve the whole problem. Obviously, fiscal discipline is imperative, but we should focus on growth because the more this economy grows, the less that debt is relative to our overall GDP.

Let me talk about Treasury market structure a little bit. That market has grown dramatically since the pandemic, from \$17 trillion to \$29 trillion today, and it is expected to double in size over the next 10 years. As that market grows, obviously, we need market participants.

Let me ask the banker, Mr. Wuerffel, why are banks important intermediaries in a growing Treasury market?

Mr. WUERFFEL. Thank you for that question. I think the Treasury market, unlike some other markets, is an over-the-counter market, which means it relies on intermediaries to move securities and cash from one buyer and from buyers to sellers. So, intermediation is essential to the Treasury market. It is one of the reasons that we think that improving intermediation and supporting intermediation is quite important. We have laid out a number of steps to do that. It can improve market safety. It can support market liquidity venues.

Importantly, we think targeted adjustments to the leverage ratios, both the SLR and the Tier 1 leverage ratio, would be important in helping to support the Treasury market’s intermediation capacity. Those ratios today constrain banks from being able to intermediate, especially in times of stress. It was intended to be a back-stop, but now it is a constraint.

Mr. BARR. Yes, and Professor Duffie, can you also talk about the importance of adjusting the SLR? I think there is a consensus developing that the Fed is impairing the liquidity of our Treasury markets by not recalibrating the SLR.

Mr. DUFFIE. Yes, Mr. Barr. The SLR is indeed a distortionary form of capital buffer. It should be changed without, in my view, reducing capital at the banks. As you said, the Treasury market has grown by leaps and bounds. The main concern is that the banks themselves have not been able to grow as quickly as the Treasury market. As I answered to Mr. Hill, the market capacity has to come from somewhere else, including all-to-all trade.

Mr. BARR. That is the short-term solution. The long-term solution is growth and fiscal discipline.

I yield back.

Chairman LUCAS. The gentleman yields back. The chair now recognizes the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman, and thank you to the panel for being here today.

How many of you would agree that we needed a trade reset? Yes? Sir? I mean, when is a good time to do it? There is never really a good time to do it, and especially considering the fact that we come off of 4 years of inflation, labor shortages, a regulatory environment out of control, there is not a good time to do it, but I will tell you what. I think that—I come from the Midwest, and I was visiting schools in Jay County, Indiana. When the school was built in the late 1970s, there was about 6,000 students in that school corporation. Today, there is about 2,300. So what does that mean? A lot of jobs left that community. That community is a—I mean, people there are smart. They are hardworking, great values. They are willing to do whatever it takes for their families and for their community.

Instead, we have seen our policies just slowly push good manufacturing jobs away. Agriculture is consolidated. That is because of technology. I mean, that is not completely government's fault. You know, there is good in that.

I will tell you what. Manufacturing has left the country because of our trade policies. I applaud President Trump for doing it. Like I said, is there a good time? Not really, and especially considering what we just came off of the last 4 years.

My question is, we have seen the jobs leave. Liberation Day, could it have been another day? Maybe April 16th would have been a better day. I do not know but it needed to happen.

So, Mr. Jersey—or actually, any of you all could answer this—would you agree that volatility in financial markets, it is inevitable?

Mr. JERSEY. Yes, it absolutely is. In fact, when interest rates were similar to where they are today, and you go back to the early 2000s, from 2004 to 2006, 2007 before the financial crisis, the range of daily Treasuries was about the same as it is today. So, this is not an unusually volatile period of time. We get days and moments that are very volatile, and that is where this illusion of liquidity that I have suggested we have plays into things. At the same time, the market is not unusually volatile on a day-to-day basis.

Mr. STUTZMAN. The other thing I would mention, too, I mean, while we want to see our Treasuries, our securities solid, here are some headlines. "Trump hails \$20 billion investment by shipping firm." "Siemens announces \$285 million investment." "Trump an-

nounces a \$500 billion AI infrastructure investment.” I know Apple has announced investment. All this investment is coming into the United States. Is that a bad thing? No, it is good. So, I appreciate the other side, and people want to say Trump’s tariff policy created all of this volatility. Yes, it sure did. I have also had investors at home say, you know what, I am making money in the market right now. I mean, some do, some do not, right?

Does volatility generally make the job of a trader more difficult? Anybody? Mr. Duffie.

Mr. DUFFIE. Yes. In some research that I did with economists at the Federal Reserve Bank of New York, we showed that volatility, as Mr. Jersey said, is a fact of life in the Treasury market, and market illiquidity in the Treasury market rises in lockstep with volatility. What we should really be concerned about is when markets become illiquid beyond the extent to which volatility suggests.

As we saw in March 2020, market dysfunction can be greater than that associated with just fundamental volatility, and that is what the government and the Fed should be focused on. Yes.

Mr. STUTZMAN. I want to say thank you. I just think that in this case here, sure, there can be fingers pointed, volatility did occur, but it was not a surprise necessarily. I mean, we all kind of knew President Trump was going to have some sort of tariff policy, and it is the ones that we are surprised by that are the ones that hurt the most and have lasted the most.

I mean, if you look at COVID and what COVID did, did it recover eventually? Yes, you can look at the trajectory, and we are kind of back on the right trajectory, but there was a lot of loss.

Anyway, thank you for your comments, and Mr. Chairman, I will yield back.

Chairman LUCAS. The gentleman yields back.

The chair now recognizes the gentlewoman from the great State of Texas, Ms. De La Cruz, for 5 minutes.

Ms. DE LA CRUZ. Thank you, Chair Lucas, and thank you for the witnesses for being here today.

I am in deep south Texas, and I have really enjoyed the conversation today and your remarks, so thank you so much for that and your time.

This question is really for all of the witnesses. What do you believe are the soundest steps that we can take to ensure U.S. reserve currency status for as long as possible? I will start with you, sir, Mr. Wuerffel.

Mr. WUERFFEL. Thank you. What I will say is I will speak to the Treasury market in particular, and I think, again, I would go back to the safety and liquidity of the market. So things that reinforce the Treasurys’ security, safety, and their liquidity, we see three key areas here.

One is to complete the central clearing rule in a timely manner because that will improve market safety. We also believe that improving Treasury market intermediation is very important. We have talked about this, including an adjustment for cash and Treasury securities in the leverage ratio that will help intermediation in the market. Third, supporting market liquidity. That can be done a number of ways, but it is all about the ability to convert a Treasury security to cash, so that is about connecting public and

private liquidity hubs, meaning you can move a Treasury security to where it needs to go to be converted to cash.

Ms. DE LA CRUZ. Thank you. Mr. Duffie.

Mr. DUFFIE. Thank you, Ms. De La Cruz. So as everyone seems to have agreed today, the most important aspect of this is U.S. deficits. So that is one component of dollar dominance.

More pertinent to today, Treasury market resilience is crucial. Treasury markets are the anchor of dollar dominance. It is also important, consistent with Mr. Wuerffel's comments, that global investors feel that they can move dollars and Treasuries easily around the world and that funding markets are open. For this reason, the Fed's swap lines with foreign central banks are crucial to ensuring that foreign banks have access to dollar funding from their own central banks.

Ms. DE LA CRUZ. Thank you. Mr. Jersey.

Mr. JERSEY. Yes, thanks very much for the question. I concur with my fellow panelists who have spoken before that reducing the deficit in particular and getting it to below the level of nominal GDP growth would be a major step to convince foreigners in particular and global investors to invest.

Also something else that is going on right now that I have to write about, unfortunately, just about every single week, and that is the debt limit, the risk of default every time we go through a debt limit crisis does affect people's perception of the safety and soundness of U.S. Treasuries. Even though everyone does expect us to always raise it, at some point, if there is a misstep and someone forgets to vote or something like that on the floor, anything that reduces the full faith and credit of the U.S. Government in the eyes of foreigners is going to be a pretty significant hit to Treasury liquidity.

Ms. DE LA CRUZ. Thank you. Ms. Cetina.

Ms. CETINA. Thank you. I would talk about the three mechanisms of, I will call it, credit creation in the U.S. economy. First, we all agree on the fiscal deficit. So, Secretary Bessent, Ray Dalio, everyone on this panel, getting that down into like a 3 percent vicinity would be very helpful.

Second is credibility is backed by confidence in the central bank and to the extent that there are discussions that could radically alter the credibility of the Fed as an institution, that is important to nip in the bud, I guess, is what I would say.

The third point I would make is a lot of what we are talking about here in terms of banks holding more Treasuries, implicitly, in my view, that implies that banks have less capacity to lend to the private sector. That is bad. I think we need to recognize that implicitly in this conversation about SLR is potentially banks lending less to small businesses in the real economy. That is something that, again, is addressed if we take care of the first problem on the fiscal deficit, so thank you.

Ms. DE LA CRUZ. Thank you so much. I would like to add to this conversation that I recently introduced a bill called Bringing the Discount Window into the 21st Century Act, which would require the Federal Reserve to conduct a review of the discount window, a key source of liquidity that small banks rely on in times of stress.

This seems to be a common theme that you all have said throughout not only this hearing but in our discussion today.

Thank you so much for your time. I yield back.

Chairman LUCAS. The gentlelady yields back. The chair now recognizes the gentleman, Mr. Downing, from Montana, for 5 minutes.

Mr. DOWNING. Thank you, Mr. Chairman, and thank you to our witnesses today.

I am glad we are having this hearing today to discuss early volatility in the Treasury market following President Trump's determination that our trading partners trade fairly with the United States. As everyone in this room is aware, this is exactly what President Trump ran on, making sure the United States is no longer taken advantage of. The trade policies of the past several decades have failed this Nation, its workers, and its communities. The U.S.' trade deficit in January totaled a whopping \$131.4 billion.

Despite the naysayers, the President's strategy is working. The United States is currently negotiating with all of its major trading partners. Just recently, the United States announced a historic trade agreement with the United Kingdom, creating unprecedented market access for U.S. producers, very meaningful to my district, especially my beef producers, but excited about that.

This was through tough negotiating posture, and President Trump forced China to the table, promising to bring future prosperity for the American workers. Already, companies have pledged to invest hundreds of billions of dollars in the United States and create hundreds of thousands of new jobs.

I am going to start first with Mr. Wuerffel. The U.S. dollar has been the global reserve currency since World War II. Having that status has allowed the U.S. to borrow at lower costs, which stimulates economic growth and increases standards of living. Critics say the President's trade policy has permanently damaged the dollar's global reserve currency status. Do you agree?

Mr. WUERFFEL. Thank you for the question. I think what we saw in April was high volatility, initially around trade policy, and then that spilled over into uncertainty around growth, inflation, and the path of fiscal and monetary policy. I think markets reacted to that by expressing price volatility. I think these types of episodes are useful reminders to focus on the structural safety and liquidity of the Treasury market, and it is that long-term ability to have a safe instrument that can be converted to cash that really matters to the structure of the Treasury market.

Mr. DOWNING. Thank you. Move on to Mr. Jersey. One theory early on regarding this episode of volatility was that foreigners dumped their Treasury securities and purchased other nations' debt as an alternative for a safe haven asset. So two parts, Is there any truth to this theory? If so, should we be concerned?

Mr. JERSEY. Unfortunately, we do not get some of the official data on Treasury flows until June for the April period, so we do not know that for sure. In my discussions with investors from Asia in particular, there were some people who said that they paused their purchases, right, as opposed to actually going out and selling. Sometimes pausing purchases is just as bad as selling out outright, depending on the liquidity situation at the time because if they

were a liquidity provider and now all of a sudden that liquidity provider goes away, prices will move to adjust to find——

Mr. DOWNING. Right, right.

Mr. JERSEY [continuing]. the next incremental buyer.

Mr. DOWNING. Thanks. Yes, it is not the first time the United States has seen volatility in the Treasury market. I worry that unaddressed liquidity episodes will only further erode the world's confidence in the Treasury market, which jeopardizes our economic and national security.

I will move to Dr. Duffie. Are there any notable similarities or differences between this most recent friction in the Treasury market with any of the previous frictions that we have had in the Treasury market?

Mr. DUFFIE. Yes. As was said by one economist, every market disruption is special in its own way. So this one, I agree with Mr. Wuerffel, was basically fundamental uncertainty coming out of trade policy and then the reactions concerning inflation and government policy going forward. It did not reach to the point where it became a crisis, and to that extent, it was much different than the COVID shock, which was a fundamental shock to the macro economy.

Mr. DOWNING. Yes.

Mr. WUERFFEL. So, I would make an important distinction between those.

Mr. DOWNING. Thank you.

Mr. Wuerffel or Mr. Jersey, anything to add? We will start with Mr. Jersey.

Mr. JERSEY. Yes, I concur with that assessment. The fact is the market was functioning, and the volatility never got to the point where you had issues with clearing Treasuries or with balance sheets that just did not exist for an extended period of time. Again, a lot of the volatility that we saw was headline-driven, so it was just investors getting in and out. They were not sure what was going on, so they were reacting to a variety of different headlines, and that created this volatility. Remember, some of this volatility was not necessarily just people selling Treasuries——

Mr. DOWNING. Right.

Mr. JERSEY [continuing]. just the opposite at times where there were people buying a lot of Treasuries during that period of time, the 7th, 8th, and 9th of April, just when you look at the trading.

Mr. DOWNING. All right, thank you.

Mr. Wuerffel, anything to add?

Mr. WUERFFEL. You know, when I think about Treasury market functioning in prior episodes, the real episodes of dysfunction had three elements. One was price volatility. That can be caused by fundamental uncertainty about different factors. Second was that the liquidity of the market, the ability to trade, deteriorated dramatically. Third is really about do funding markets, the ability to finance the Treasury security and borrow cash, start to express stress?

We have not seen that kind of trifecta in April. We did see volatility in prices, deterioration in some liquidity, but really, funding markets held up fairly well, and uncertainty decreased over time, and I think market functioning was——

Chairman LUCAS. Thank you.

Mr. WUERFFEL. Mr. Chair, I yield.

Chairman LUCAS. The gentleman's time has expired.

The chair now recognizes the gentleman from Wisconsin, Mr. Fitzgerald, for 5 minutes.

Mr. FITZGERALD. Thank you, Chairman.

Mr. Wuerffel, I know we kind of went over some of this stuff earlier this morning, but can you explain again how the leverage ratio may discourage banks from providing liquidity to the Treasury market, in particular, kind of in times of stress?

Mr. WUERFFEL. Sure. The Treasury market requires intermediaries to function well because it is not an exchange-traded market. So, the capacity of intermediaries to carry out that activity is very important.

The leverage ratio was designed as a backstop to guard against risks, but today, it serves as, in some cases, the first line of defense, and it constrains banks from intermediating, especially in times of stress. What we would say is that having a targeted adjustment to the SLR, as well as the tier 1 leverage ratio could help boost capacity in those times of stress so you are not bumping up against the leverage ratio. If the policy objective is to support Treasury market liquidity, it would help with that. It can also be done in a way that continues to have a safe and sound banking system.

Mr. FITZGERALD. As U.S. debt issuance continues to grow, do you believe that the current leverage ratio framework is adequately supporting kind of the health and resilience of the Treasury market?

Mr. WUERFFEL. So as some of the panelists have noted, the size of the Treasury market has really outpaced the growth in intermediation capacity dramatically. So, that trajectory of the government market is important, first of all, to have a sustainable fiscal trajectory. That is important, but also to support intermediation in that growing marketplace, and I think that is why making these sort of targeted adjustments and looking at the things that constrain capacity on intermediaries is quite important.

Mr. FITZGERALD. As someone who represents a district that is heavy in manufacturing, specifically light manufacturing, and with the tariffs, that if I go back to 2020, it was kind of a line of manufacturers kind of at my door saying, if there is any way we can get an exemption, that would be wonderful, right? That is kind of—that whole discussion has begun again.

Mr. Jersey, let me ask you kind of on a bigger scale, would getting our fiscal house in order—I know we have talked a lot about the national debt right now—as well as growing the economy, which there was a couple references to President Clinton and, what was the magic back then that got us back to a balanced budget. How do you think that those changes could help reassure investors that Treasuries are a safe haven asset, really, of the entire world?

Mr. JERSEY. Thanks very much for the question. It really is just having a sound fiscal house, number one; and, number two, ensuring a lot of these regulations are enacted so people know that they can transact easily. That will certainly help investors not only

abroad but also here in the United States be comfortable holding Treasury securities in both the long and short term.

We have to remember, a lot of people adjust their interest rate exposure using Treasury securities. So, let us say that you own corporate bonds on one side. You might hedge that by selling a Treasury or selling a Treasury future or paying in an interest rate swap. All of those things are true. So, our corporate bond market actually works better because we have a liquid, sound, safe Treasury market. By enhancing liquidity in the Treasury market, you are not only enhancing liquidity for the government, but enhancing liquidity for businesses in the United States as well.

Mr. FITZGERALD. Very good. Thank you. Chairman, I yield back.

Chairman LUCAS. The gentleman yields back.

The chair now recognizes the gentleman from Nebraska, Mr. Flood, who is also Chair of the Subcommittee on Housing and Insurance for 5 minutes.

Mr. FLOOD. Thank you, Chairman.

Continued robust demand for U.S. Treasuries is foundational to our economy, and disruptions in the Treasury market have enormous consequences for the United States and countries around the world. The focus of this hearing today is the volatility in Treasury markets in April, following the White House announcements that tariff policies were going to undergo a rehaul as part of what we call Liberation Day.

To recap, after the tariff announcements, the stock market plummeted, and the 10-year yield initially dropped 20 basis points before quickly jumping 40 basis points over the course of the next couple of days. I would like to ask our panelists about each of those events I just summarized separately to better understand what may have caused them.

Let us start with the initial movement post-Liberation Day where both the stock market went down and the 10-year bond yields moved down as well. To my understanding, this movement is roughly in line with what one would expect in the event of instability in the stock market. Treasuries are considered to be a safe haven, and often when money is pulled out of the stock market, a natural safe place to divert it would be Treasuries. As demand for Treasuries go up, yields should go up.

Mr. Wuerffel, Mr. Duffie, Mr. Jersey—and this is just looking for a brief answer here—is it fair to say that it is typical to see bond yields drop in the event of rapid flight of capital from the stock market?

Mr. JERSEY. Yes, it is. One of the things that you have to realize during that period of time as well is not all Treasury yields rose during that period of time. Short-term Treasury yields actually went down because of the expectation of—I am not saying this was my expectation; this was the market's expectation—of a slower economy and a Federal Reserve going to be cutting interest rates. In doing so, you saw, yes, 10-year yields rose, but short-term yields like 2-year yields went down.

Mr. FLOOD. Mr. Duffie.

Mr. DUFFIE. Mr. Flood, the fact that the Treasuries are a safe haven for investors involves two different features. One is the one you mentioned, and you had diagnosed it perfectly. As risk rises,

investors tend to flee to quality, and that is the U.S. Treasury market. The second phase is once the risks materialize into a serious crisis, many investors want to sell their Treasuries and go to cash. It is at that point that Treasury yields could rise if the market cannot handle that. That is what we saw, for example, in the COVID shock. So, both market depth and the quality of the U.S. Government's credit are crucial to that safe haven role.

Mr. FLOOD. Mr. Wuerffel.

Mr. WUERFFEL. I agree with the fellow panelists here. I think the initial reaction was one that we typically see, which is that, as a safe haven instrument, investors, when facing risk, can move into Treasury securities. Some of that movement then reversed as uncertainty spilled over into other questions about the trajectory of growth and inflation and fiscal and monetary policy.

Mr. FLOOD. Okay, great. That is what I expected. Now comes the interesting part. Then the 10-year yields rise. We just established that a drop in yields in an environment with a flight of capital from the stock market is normal. That makes this increase in yields, while the stock market continued to remain volatile, seem so much stranger by comparison.

I have heard a few different explanations of this. One is that inflation expectations had increased and that yields responded to a new perception around inflation. A second was that institutional investors were forced to liquidate positions that were highly leveraged due to volatility. One more theory was that foreign investors were spooked and trying to offload U.S. debt altogether.

We will start on the other end this time with Mr. Wuerffel and then go to Mr. Duffie and then Mr. Jersey. I would be interested to hear from each of our panelists that I just identified and what they think the cause of this Treasury yield activity was specifically and whether it is one of the potential explanations I just used or a combination of them or something else entirely.

Mr. WUERFFEL. Thank you for that question. I think it is a combination of factors that uncertainty around, in the first instance, trade policy, and then drove uncertainty around some fundamental factors that drive interest rates, things like the growth, the macroeconomic growth, the trajectory for inflation, what fiscal and monetary policies might do, and even the size of Treasury debt outstanding. So all of those things drive interest rates, and there were upside and downside scenarios for those, and I think that is why we saw such volatility in the market.

Mr. FLOOD. Mr. Duffie.

Mr. DUFFIE. I agree. Inflation and fiscal uncertainty were the main sources of volatility. We do not know yet, Mr. Flood, whether in fact foreign investors did unload Treasuries. As Mr. Jersey said, those data will only become available in June. There are early indications: The Ministry of Finance of Japan does publish faster data and show that around 20 billion of U.S. bonds, corporate bonds and Treasuries, were sold around early April. That is not an enormous amount. It sounds like a lot, but it is not an enormous fraction of foreign holdings of bonds. So, I am going to speculate that, once all the data come out, we are going to find that there was not massive selling of Treasuries, but there was repricing on the volatility that Mr. Wuerffel mentioned.

Mr. FLOOD. I appreciate that, and my time is up, so I yield back.
Chairman LUCAS. The gentleman yields back.

The chair would like to thank all of our witnesses for some really exceptional testimony today. I would note my one takeaway is the financial markets are a lot like Congress. We are both rational until we are irrational.

Without objection, all members will have 5 legislative days to submit additional written testimony and questions for the witnesses to the chair. The questions will be forwarded to the witnesses for their response. Witnesses, please respond no later than June 23, 2025.

[The information referred to can be found in the appendix.]

This hearing is adjourned.

[Whereupon, at 11:34 a.m., the Task Force was adjourned.]

APPENDIX

MATERIALS SUBMITTED FOR THE RECORD



Bank Policy Institute Statement for the Record

Before the Task Force on Monetary Policy, Treasury Market Resilience and Economic Prosperity

"Examining Treasury Market Fragilities and Preventative Solutions"

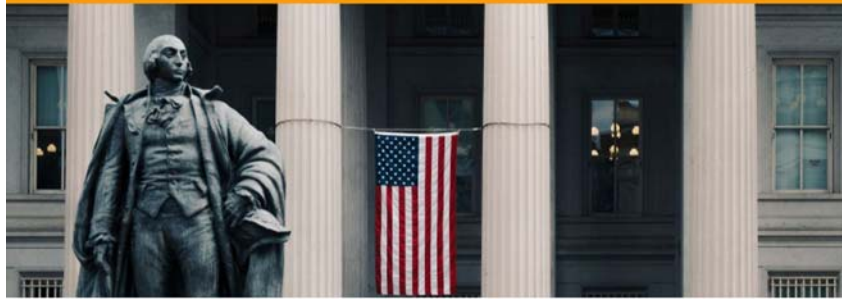
May 15, 2025

Dear Chairman Frank Lucas, Ranking Member Juan Vargas and Honorable Members of the Task Force:

The Bank Policy Institute welcomes the opportunity to provide input to the Committee on its hearing on "Examining Treasury Market Fragilities and Preventative Solutions." Leverage capital requirements, including the supplementary leverage ratio, constrain banks' ability to intermediate in the Treasury market. These capital requirements, which treat all assets the same regardless of risk level, are meant to serve as a backstop, not a binding constraint.

Treasury securities have grown while banks' balance sheet capacity remains limited. The confluence of capital and liquidity regulations has had a contradictory impact on banks' balance sheets, with banks holding lots of Treasuries to meet liquidity requirements but being constrained by capital requirements from actively intermediating. The result: Less capacity for providing liquidity and depth in the Treasury market, and greater risk of market instability in stressful times. Reforming leverage capital requirements, including the SLR – a long-overdue change – would unlock capacity to intermediate and bolster the resilience of this critical market.

We respectfully submit the following resources for your consideration, which further outline our views.



Treasury Market Resiliency and Large Banks' Balance Sheet Constraints

BPI Staff | Feb. 6, 2025

The U.S. Treasury market faces increasing intermediation challenges that could threaten its stability and resilience. Since 2007, outstanding Treasury securities have grown nearly fourfold relative to primary dealer balance sheets, as post-crisis regulatory capital requirements have constrained dealers' ability to make markets effectively and reduced market depth.

The decline in intermediation capacity is evident in some of the changes seen in the composition of bank balance sheets. Large banks, which usually include a primary dealer entity, have significantly increased their Treasury holdings. Data from regulatory reports shows that the share of U.S. Treasuries relative to total assets has expanded from 3 percent in 2013 to 11 percent in 2024. Other high-quality liquid assets such as deposits at Federal Reserve banks and agency mortgage-backed securities have also increased materially in recent years.

This seemingly contradictory situation—where dealers' market-making capacity has decreased while banks' Treasury holdings have increased—can be explained by the dual impact of post-crisis regulations on bank balance sheets. While capital requirements have constrained dealers' ability to actively intermediate in the Treasury market, liquidity regulations have simultaneously incentivized banks to hold more high-quality liquid assets, including Treasuries. As a result, although large banks hold more Treasuries, their capacity to provide liquidity and depth to the market has not kept pace with the growth in outstanding Treasury securities.

The expansion in holdings of Treasuries and other low-risk assets has not affected risk-based capital ratios, but has driven down banks' leverage ratios, particularly the enhanced supplementary leverage ratio (eSLR). Currently, three of the six largest bank holding companies are bound by the eSLR, preventing further Treasury purchases unless they reduce other assets or raise capital. When leverage ratios become binding, banks have the incentive to decrease low-risk activities, such as intermediating in Treasury and Treasury repo markets.

Furthermore, during periods of market stress, banks typically experience a significant influx of deposits, which can lead to capital constraints imposed by the SLR and the Tier 1 leverage ratio. If it is costly for banks to raise new external capital during these stress times, they will be further incentivized to reduce their lending activities and other financial intermediation services to economize capital. This contraction in banking activity would worsen the effect of the initial market stress, amplifying damage to the broader financial system.

The resulting decline in intermediation capacity of banks raises significant financial stability concerns, as evidenced by multiple market disruptions. As capital constraints limit traditional intermediaries, Treasury market intermediation increasingly relies on principal trading firms (PTFs).¹ However, PTFs operate with short-term strategies and, unlike primary dealers, are less willing to make markets during stress periods. Furthermore, PTFs principally provide liquidity for on-the-run Treasury issues and liquidity for off-the-run issues remains dependent on dealer intermediation.

Assuming Treasury issuance continues to expand due to fiscal deficits, banks will be disincentivized to support that market. To preserve market functioning, bank regulators could simply recalibrate the eSLR — something they proposed to do in 2018 but never did for political reasons — and modify the Tier 1 leverage ratio. These adjustments are critical for enabling banks to accommodate the growing supply of Treasuries.

The Role of Primary Dealers in the U.S. Treasury Market

The U.S. Treasury market, where \$28 trillion of outstanding securities are currently bought and sold, is considered the world's deepest and most liquid securities market. However, it has experienced periods of dysfunction, including notable disruptions in March 2020, September 2019 and October 2014.

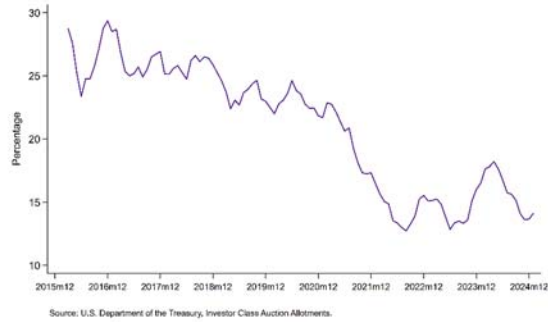
In the Treasury market, dealers serve as important intermediaries, facilitating trades with a broad range of clients, including foreign central banks, asset managers, pension funds and hedge funds. These dealers maintain significant balance sheets to support longer-term positions and larger trades, often warehousing securities when there is no immediate offsetting interest. The role of dealers is especially important in the off-the-run securities market (any Treasury security that has been issued), where their ability to hold positions until matching buyers or sellers emerge is necessary for market functioning.

However, while dealers remain essential liquidity providers, their intermediation capacity has not kept pace with the growing Treasury market size. Since 2007, the total amount of Treasuries outstanding has grown nearly fourfold relative to primary dealer balance sheets. This trend continues due to large U.S. fiscal deficits and regulatory capital constraints. All of the largest dealers operate within bank holding company subsidiaries, making their balance sheets subject to both capital and liquidity regulations. More specifically, the eSLR introduced in 2014, along with other post-crisis capital requirements like global systemically important bank (GSIB) capital surcharge, have significantly constrained dealers' willingness and ability to intermediate trades.

Figure 1 shows that the primary dealers' share of longer-term Treasuries at auctions has been declining since the introduction of these banking regulations, a trend that appears to have intensified in the post-pandemic period.

¹ Principal trading firms are smaller, nonbank firms that trade on electronic platforms using automated trading strategies. They are important providers of short-term liquidity in Treasury markets.

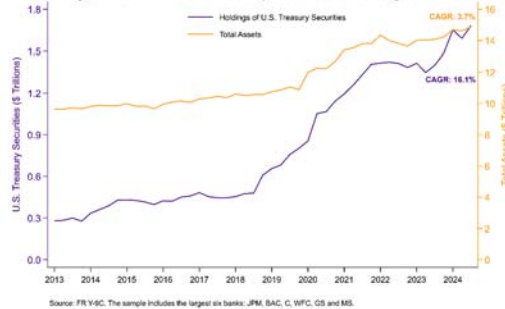
Figure 1: Primary Dealer Share of Auction Awards of Longer-Term Treasuries



Evolution of Large Banks' Holdings of U.S. Treasury Securities

Analyzing the trends in large banks' Treasury holdings provides insights into why their capacity to make markets efficiently has declined. The data show that post-crisis rules have materially changed the balance sheet composition of large banks. While the largest banks' total assets grew modestly at 3.8 percent during the 2013-2014 period, holdings of U.S. Treasury securities surged at more than 16 percent annually, as shown in Figure 2. The sizable shift toward U.S. Treasury securities reflects a fundamental shift in the asset allocation strategies of the largest banks. In terms of balance sheet share, the share of USTs in total assets has gone from 3 percent of total assets in 2013 to 11 percent of total assets in the third quarter of 2024.

Figure 2: Growth of U.S. Treasury Securities at the Largest Banks



According to some recent academic papers, large banks have increased their holdings of Treasury securities post-Global Financial Crisis for several key reasons:²

- Increased capital requirements following the global financial crisis (namely Basel III, GSIB surcharge and stress testing), particularly for the largest banks, have reduced banks' incentives to make loans. Since larger banks face higher capital requirements for loans than smaller banks, they have shifted their portfolio toward liquid assets such as Treasury securities and away from loans.
- The introduction of liquidity requirements has forced large banks to increase their holdings of high-quality liquid assets, which include Treasury securities, in place of loans.³
- Growing competition from nonbank lenders in traditional corporate lending markets has pushed banks to reallocate their assets toward securities.

An important consequence of the largest banks' increased holdings of U.S. Treasury securities has been to make leverage ratios, particularly the supplementary leverage ratio, more binding on these institutions.

For this purpose, it is crucial to note that securities held by bank holding companies at the insured depository institution for compliance with liquidity regulation or as investment assets are not typically available for use in broker-dealer intermediation. Thus, it is possible for the holding company to be awash in Treasury securities while its broker-dealer subsidiary simultaneously experiences a shortage of them.

Banks' Balance Sheet Capacity to Hold Low-Risk Assets Has Been Declining

The SLR is defined as the ratio of Tier 1 capital to total leverage exposure. Total leverage exposure includes on-balance-sheet assets and certain off-balance-sheet exposures, such as derivatives and securities financing transaction exposures, and credit-equivalent amounts of loan commitments. Under the eSLR framework, the largest banks must maintain a three percent minimum requirement plus an additional two percent eSLR buffer, while their insured depository institution subsidiaries must maintain a 6 percent eSLR to be considered "well capitalized."

To determine what factors have made the eSLR increasingly binding over time, we examine banks' capacity to absorb securities that have a zero risk weight under risk-based requirements, such as U.S. Treasuries, without triggering the eSLR as the binding requirement. Specifically, we calculate the additional amount of Treasury securities a bank could hold without increasing its overall Tier 1 capital requirements. For example, a bank holding company for which the eSLR currently generates the highest Tier 1 capital requirement has no remaining balance sheet capacity for additional Treasury securities.

To determine balance sheet capacity, we first calculate the Tier 1 capital banks must hold to meet risk-based requirements. These are determined by Basel III risk-weighted assets, the stress capital buffer and the GSIB surcharge.⁴ We also assume that banks maintain buffers over these requirements of 50 basis

² See for example "Stulz, Rene, Alvaro Taboada, Mathijs van Dijk, "Why are Bank Holdings of Liquid Assets so High?" NBER Working paper 30340, May 2023 and Hanson, Samuel, Victoria Ivashina, Laura Nicolae, Jeremy Stein, Adi Sunderam, and Daniel Tarullo, "The Evolution of Banking in the 21st Century: Evidence and Regulatory Implications," Brookings Papers on Economic Activity, Spring 2024.

³ See for example "Sundaresan, Suresh and Kairong Xiao, "Liquidity regulation and banks: Theory and evidence," Journal of Financial Economics, Vol. 151, January 2024.

⁴ Prior to the adoption of the stress capital buffer in 2020, we assume the implied SCB equals the maximum decline in each bank's common equity tier 1 capital ratio under the Fed's stress tests. While this proxy is somewhat imperfect because it includes dividends paid in each quarter

points for their Tier 1 risk-based requirement and 25 basis points for their eSLR requirement. Table 1 presents the balance sheet capacity calculations for each of the largest banks as of the third quarter of 2024. The results show that three of the six banks are bound by the eSLR, indicated by zero balance sheet capacity. This means these banks cannot increase their Treasury holdings without needing to fund themselves with additional Tier 1 capital.

Table 1: Current Balance Sheet Capacity to Hold US Treasuries

Banks (\$ Billions) as of q32024	eSLR – Current Framework			
	Tier 1 Requirement Risk-Based	Tier 1 Requirement eSLR	Effective Minimum eSLR Requirement	Balance Sheet Capacity
JPM	248	257	5.25%	0
BAC	203	199	5.25%	72
C	165	158	5.25%	135
WFC	133	119	5.25%	270
GS	105	111	5.25%	0
MS	73	80	5.25%	0
Total	926	923	–	478

Note: The table assumes management buffers of 50 basis points for Tier 1 risk-based requirement and 25 basis points for the SLR requirement.

Figure 3 shows how balance sheet capacity at the largest banks has evolved since the adoption of the eSLR. The capacity of U.S. GSIBs to acquire additional Treasuries has shown a persistent decline since 2016, consistent with the increase in the proportion of U.S. Treasuries in banks' balance sheets shown in Figure 2.

A perfect test case to determine the impact of the SLR came in April 2020, when the Federal Reserve temporarily removed reserves and U.S. Treasuries from the denominator of the SLR calculation for banks.⁵ This action was taken because the lack of dealer intermediation capacity had forced the Fed to make massive purchases of U.S. Treasury securities to address market dysfunction. The dysfunction occurred when a dash for cash during the onset of the COVID-19 pandemic overwhelmed dealer intermediation capacity.

By excluding cash and Treasuries from the SLR denominator, the Fed effectively lowered the amount of capital banks were required to maintain against these assets, freeing up their balance sheets to support the Treasury market and the economy during the crisis. According to Koont and Walz (2021), the relaxation of the SLR during COVID increased bank credit supply and improved Treasury market liquidity.⁶

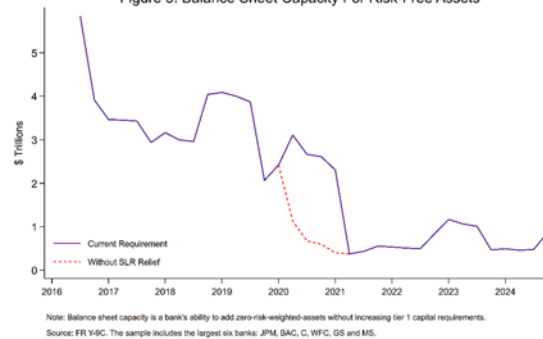
of the planning horizon, rather than the four quarters of dividends included in the actual SCB calculation, it remains sufficient for the purposes of this analysis.

⁵ In April 2020, the Federal Reserve Board allowed banks to deduct deposits held at Federal Reserve Banks ("reserve balances") and Treasury securities from the denominator of the SLR on a temporary basis. Press Release, "Federal Reserve Board announces temporary change to its supplementary leverage ratio rule to ease strains in the Treasury market resulting from the coronavirus and increase banking organizations' ability to provide credit to households and businesses," April 1, 2020. <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm>.

⁶ See Koont, Naz and Stefan Walz, "Bank Credit Provision and Leverage Constraints: Evidence from the Supplementary Leverage Ratio," Columbia Business School Research Paper, July 2021. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3798714. For the positive effect of the SLR relief announcement by market participants, see The Fed – Impact of Leverage Ratio Relief Announcement and Expiry on Bank Stock Prices.

After the expiration of the temporary SLR relief in March 2021, the Fed stated that it would soon invite comments on several potential modifications to the SLR.⁷ However, nearly four years later, after political criticism of any step to provide capital relief to banks, no public consultation has been launched.

Figure 3: Balance Sheet Capacity For Risk-Free Assets



Reforming Leverage Ratios

The Federal Reserve and the Office of the Comptroller of the Currency published a proposal in 2018 to tailor the eSLR for U.S. Global Systemically Important Banks.⁸ The proposal aimed to incentivize firms to engage in low-risk activities by adjusting the 2 percent eSLR buffer to one-half of the Method 2 GSIB surcharge. At that time, all GSIBs had Method 2 surcharges below 4 percent, meaning this modification would have increased their balance sheet capacity. Crucially, the proposal included changes to the eSLR buffer at the lead insured depository institution, which would allow banks to optimize capital allocation across different subsidiaries, including broker-dealers. In other words, the relaxation of capital requirements at the bank level allows for more capital to be deployed to broker-dealer subsidiaries and increases the balance sheet capacity of the broker-dealer.

Given the growth in GSIB surcharges due to economic growth and inflation, U.S. regulatory agencies could consider reissuing the eSLR proposal with a modification: replacing the 2 percent eSLR buffer with one-half of the Method 1 rather than the Method 2 surcharge. This approach aligns with Basel standards and matches how the eSLR buffer is defined. The U.S. version of the GSIB surcharge (Method 2) is about twice as high as the surcharge under Method 1 for several banks, as demonstrated in Table 2.

Lastly, Afonso, Gara, Marco Cipriani and Gabriele La Spada, "Banks' Balance-Sheet Costs, Monetary Policy, and the ON RRP," Federal Reserve Bank of New York Staff Reports, no. 1041 December 2022; revised August 2024, show that the expiration of the SLR relief incentivized banks to shed deposits and reduce participation in financial markets.

⁷ A year later, with the Treasury market stabilized, the Federal Reserve allowed those changes to expire but announced in a press release that "[t]o ensure that the SLR—which was established in 2014 as an additional capital requirement—remains effective in an environment of higher reserves," they "will soon be inviting comment on several potential SLR modifications." Press Release, "Federal Reserve Board announces that the temporary change to its supplementary leverage ratio for bank holding companies will expire as scheduled on March 31," March 19, 2021. <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210319a.htm>.

⁸ In any future reproposal, it would be essential for the Federal Deposit Insurance Corporation (FDIC) to participate in the rulemaking process, as some bank-level requirements would affect FDIC regulations. For example, these changes could impact a bank's ability to roll over existing brokered deposits or accept new ones without requiring a waiver.

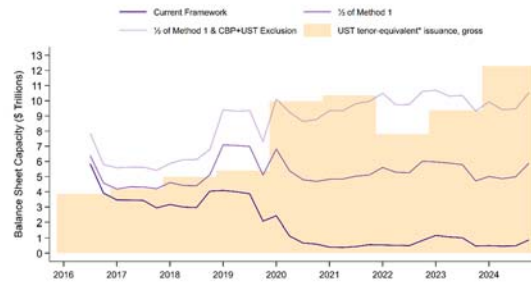
Table 2: GSIB Surcharges and Potential Deductions from SLR Denominator

	GSIB Surcharge		Assets to be Deducted	
	Method 2	Method 1	Central Bank Placements	U.S. Treasuries
JPM	4.5%	2.5%	415.8	457.2
BAC	3.0%	1.5%	263.9	394.8
C	3.5%	2.0%	282.2	322.5
WFC	1.5%	1.0%	153.6	71.7
GS	3.0%	1.5%	102.0	291.8
MMS	3.0%	1.0%	28.2	144.7

Alternative approaches to adjust the eSLR include adopting changes similar to those implemented during the COVID-19 pandemic, specifically deducting both central bank deposits (Federal Reserve and foreign central banks) and U.S. Treasury securities from the calculation.⁹

Another option would be to combine the eSLR buffer modification with these denominator deductions. This combined approach would more effectively tailor the eSLR, as it would apply to all banks subject to the supplementary leverage ratio, not just the largest banks. Such a change could broaden and diversify the supply of Treasury and Treasury repo market intermediation.

Figure 4: Balance Sheet Capacity under Separate eSLR Calibrations



* For each Treasury bill (T-bill) with a tenor of less than 52 weeks, we calculate the adjusted issuance amount by dividing the gross issuance amount by the ratio of 52 to the number of weeks in the T-bill's tenor.

Source: FR Y-9C. The sample includes the largest six banks: JPM, BAC, C, WFC, GS and MS.

Figure 4 illustrates the impact of each proposed adjustment to the eSLR on the balance sheet capacity of the largest banks. The chart also includes data on U.S. Treasury issuance. This comparison highlights

⁹ We have included both U.S. Treasury securities reported in the banking book (Schedule HC-B) and in the trading book (Schedule HC-D).

how the eSLR needs to adapt to ensure banks can continue to support the liquidity of the Treasury market effectively.

Furthermore, the U.S. agencies need to make similar adjustments to the Tier 1 leverage ratio. Since there is no buffer in this ratio, relief requires excluding central bank placements and U.S. Treasury securities from its denominator. However, this approach faces a constraint under the “Collins Amendment,” which prohibits minimum leverage capital requirements from falling below the [generally applicable leverage capital requirements](#) that were in effect for [insured depository institutions](#) as of July 21, 2010.¹⁰ Congressional action would therefore be needed to allow regulatory agencies to exclude central bank placements and U.S. Treasuries from the Tier 1 leverage ratio denominator while maintaining compliance with the Collins Amendment’s floor requirements.

Lastly, the denominator changes to leverage ratios would not be compliant with the Basel standards when assessed on a rule-by-rule basis, highlighting the need for a more comprehensive evaluation method. On a holistic basis, the application of a 4 percent Tier 1 leverage ratio imposes stricter constraints on U.S. Treasuries and reserve balances than those required by Basel. This raises questions about the appropriateness of such stringent capital requirements, especially for low-risk assets. Furthermore, the current regulatory framework appears to result in leverage ratios becoming the binding requirements for U.S. banks, which was not the original intent of the Basel framework. To address this, policymakers should strive for a balance between international compliance and more risk-sensitive capital requirements tailored to the U.S.

Conclusion

Large banks’ balance sheets have undergone significant changes in response to post-Global Financial Crisis regulations. Current leverage ratio calibrations have made leverage requirements binding constraints for many of the largest banks. These constraints are likely to become more binding during economic downturns, particularly when banks experience substantial deposit inflows and increase their holdings of risk-free assets.

U.S. regulatory agencies should reassess these leverage ratio calibrations. Several options exist to enhance large banks’ capacity to hold additional U.S. Treasury securities during periods of increased issuance. Implementation requires coordinated action through joint rulemaking by all three regulatory agencies, as changes must apply both at the bank holding company level and at the lead insured depository institution level.

To provide broad relief, the agencies must be willing to allow the definition and calibration of the SLR to deviate from certain Basel requirements, provided U.S. capital requirements remain holistically as stringent as the Basel requirements. Finally, congressional action may be necessary to implement needed reforms to Tier 1 leverage requirements.

Disclaimer: The views expressed do not necessarily reflect those of the Bank Policy Institute’s member banks, and are not intended to be, and should not be construed as, legal advice of any kind.

¹⁰ The Collins Amendment stipulates that generally applicable minimum leverage requirements under Prompt Corrective Action (PCA) cannot be lower than their 2010 levels. As of 2010, the minimum requirement for a bank to be considered adequately capitalized under PCA was 4% Tier 1 leverage ratio. However, the pre-2010 PCA regime allowed for a lower minimum of 3% for banks meeting specific criteria, including a CAMELS 1 composite rating. Consequently, one interpretation of the Collins Amendment could potentially allow regulatory agencies to reduce the Tier 1 leverage minimum to 3%, aligning with the lower threshold permitted under certain conditions in the pre-2010 framework.



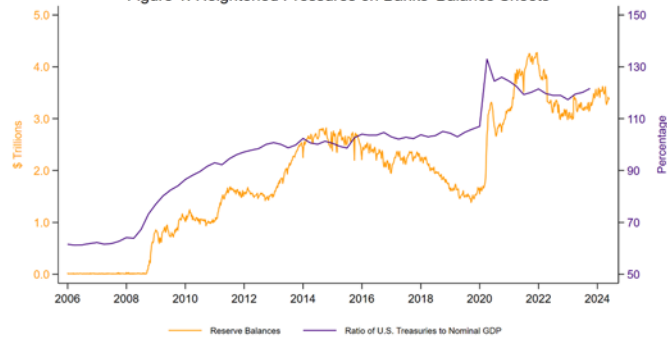
Empty Promises: Revisiting the Reasons to Fix the Supplementary Leverage Ratio

BPI Staff | July 8, 2024

Leverage ratios by definition are risk-insensitive. Due to this nature, they were designed and intended as complementary backstops to risk-based capital requirements for banks, a safeguard that ensures a minimum level of capital even if risk-based requirements prove inadequate. Leverage ratios, such as the supplementary leverage ratio, were not designed to be binding constraints that frequently determine the amount of capital banks must hold.

When a leverage ratio becomes the binding constraint on a bank's capital allocation, it creates incentives that can distort a bank's behavior and undermine the efficiency of risk-based requirements. For example, a binding leverage ratio disincentivizes banks to act as dealers in low-risk assets, such as U.S. Treasury securities. This is because such activities become relatively expensive in terms of capital under a leverage ratio view, despite their low risk. Consequently, this could reduce liquidity in these important markets.

Figure 1: Heightened Pressures on Banks' Balance Sheets



Source: FRED, Federal Reserve Economic Data.

Several factors have contributed to the SLR becoming a more binding constraint over time for the largest banks. As Figure 1 illustrates, the growth of safe assets, particularly U.S. Treasury securities and deposits held at Federal Reserve Banks (or reserves), has considerably outpaced the growth of banks' intermediation capacity. It is important to note that while banks are not the only holders of Treasury securities, and shouldn't be, they play a crucial role in market intermediation.

Large fiscal deficits have fueled the growth in government debt, while the Fed's quantitative easing programs and changes to the Fed's monetary policy framework have substantially increased the long-term supply of reserves. Although the current level of deposits at Federal Reserve banks is only slightly higher than the level when the SLR rule was finalized in 2014, FOMC minutes from that time projected a decline in reserves to \$25 billion by 2021, a projection that did not materialize.¹

In summary, the discrepancy between projected and actual reserve levels, combined with the growth in Treasury issuance, has put pressure on banks' balance sheets and their ability to provide liquidity in these markets.

Indeed, in April 2020, the Fed temporarily removed reserves and U.S. Treasuries from the denominator of the SLR calculation for banks.² This was done in response to the Fed's massive purchases of U.S.

¹ When the Federal Reserve adopted the eSLR in April 2014 at an open Board meeting, several Board members expressed concern about the unintended consequences of a binding leverage ratio. Staff noted that the impact of the SLR on bank balance sheets would likely be modest in part because "the level of reserve balances will be lower in the future as the size of the Federal Reserve's balance sheet is reduced. . . ." Federal Reserve Board, "Transcript of Open Board Meeting" at 8 and 15 (April 8, 2014), <https://www.federalreserve.gov/mediacenter/files/open-board-meeting-transcript-20140409.pdf>. See also footnote 5 on page 41 of the April 2014 "Report to the FOMC on Economic Conditions and Monetary Policy" part B, available at <https://www.federalreserve.gov/monetarypolicy/files/FOMC20140430tealbookb20140424.pdf>.

² In April 2020, the Federal Reserve Board allowed banks to deduct deposits held at Federal Reserve Banks ("reserve balances") and Treasury securities from the denominator of the SLR on a temporary basis. Press Release, "Federal Reserve Board announces temporary change to its supplementary leverage ratio rule to ease strains in the Treasury market resulting from the coronavirus and increase banking organizations' ability to provide credit to households and businesses," April 1, 2020, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm>.

Treasury securities in response to the market dysfunction caused by the COVID-19 pandemic. By removing cash and Treasuries from the SLR denominator, the Fed effectively lowered the amount of capital banks needed to hold against these assets, freeing up their balance sheets to support the Treasury market and the economy during the crisis. After the expiration of the temporary SLR relief in March 2021, the Fed stated that it would soon invite comments on several potential modifications to the SLR.³ However, more than three years later, no public consultation has been launched.

GSIBs are also subject to an additional buffer on top of their SLR, called the enhanced supplementary leverage ratio or eSLR, which requires them to maintain a two percent buffer at the BHC level and a three percent buffer at the IDI level. In 2018, the Federal Reserve and the OCC consulted on a proposal that would have modified this eSLR and reduced the size of these buffers; however, the FDIC did not join in the proposal, which was never finalized.

Both Chair Jerome Powell and Vice Chair for Supervision Michael Barr have expressed support for adjusting the SLR to facilitate Treasury market intermediation. In September 2021, Chair Powell stated that the Federal Reserve was considering modifying the SLR without reducing overall capital requirements to ensure leverage ratios are not binding constraints, as this would encourage banks to take on more risk.⁴ Similarly, in his July 2023 speech detailing his planned “holistic capital review,” Vice Chair for Supervision Barr noted that “[t]o the extent that there are problems with Treasury market intermediation in the future for which the eSLR might matter, the Board could consider an adjustment.”⁵ However, in the same address, Barr further noted that “the eSLR generally will not act as the binding constraint at the holding company level, where Treasury market intermediation occurs” and that “if problems arise, [we] will consider appropriate policy responses.”

Under the banking agencies’ original Basel Endgame proposal, which includes a 19 percent increase in risk-based capital requirements for the largest banks, the eSLR would be less likely to act as a binding constraint, at least initially, before bank portfolio adjustments in response to its changes. However, recent [reports](#) suggest that the banking agencies are likely to make significant changes to the Basel proposal, which will materially increase the likelihood of binding leverage ratios, as we explain in more detail below.

How Binding are Leverage Ratios?

One way to assess whether banks are bound more by risk-based capital or leverage requirements is to calculate how much capital banks hold above required minimums and buffers for both risk-based and leverage ratio requirements. The results are shown in Figure 2. Two sets of bars are presented: one measuring the amount of excess capital for risk-based requirements (Tier 1 capital) and the other for the eSLR, which is also measured using Tier 1 capital. The lower the bar, the more likely a bank is to be constrained by either the risk-based requirements or the leverage requirement. For example, in Figure 2

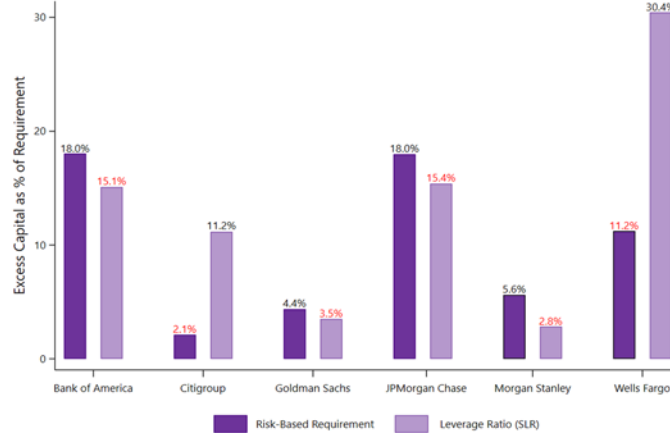
³ A year later, with the Treasury market stabilized, the Federal Reserve allowed those changes to expire but announced in a press release that “[t]o ensure that the SLR—which was established in 2014 as an additional capital requirement—remains effective in an environment of higher reserves,” they “will soon be inviting comment on several potential SLR modifications.” Press Release, “Federal Reserve Board announces that the temporary change to its supplementary leverage ratio for bank holding companies will expire as scheduled on March 31,” March 19, 2021, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210319a.htm>.

⁴ United States Senate Committee on Banking, Housing, and Urban Affairs, “Full Committee Hearing: CARES Act Oversight of the Treasury and Federal Reserve: Supporting an Equitable Pandemic Recovery” (September 28, 2021), <https://www.banking.senate.gov/hearings/cares-act-oversight-of-the-treasury-and-federal-reserve-supporting-an-equitable-pandemic-recovery> (1:39:30).

⁵ Michael Barr, “Holistic Capital Review,” Speech at the Bipartisan Policy Center (Jul. 10, 2023), available at <https://www.federalreserve.gov/newsevents/speech/barr20230710a.htm>.

below, JPMC is more likely to be constrained by the eSLR, which is the lower bar of the two measures. As illustrated below, among the largest banks, the eSLR is binding—not a backstop to risk-based requirements—for four out of the six largest banks.⁶ Notably, these banks are also some of the most significant providers of intermediation in the Treasury market.

Figure 2: Excess Capital with Current Requirements



Binding at the Bank Level

Banking organizations can be bound by leverage at the bank holding company level or at the level of their insured depository institutions. When bound at the bank level, Tier 1 leverage ratio requirements can adversely affect the efficient implementation of monetary policy by creating artificial constraints on deposit capacity. This implies a significant constraint on the ability of these institutions to accept customer deposits. As custody banks, STT and BK play an important role in facilitating financial flows, and constraints on their deposit capacity could impact the effectiveness of monetary policy and the allocation of capital. To maintain consistency across leverage ratios (and regardless of business models), the banking agencies should also consider appropriate adjustments to Tier 1 leverage ratios.⁷

In the initial Basel III proposal, the agencies estimate that changes to RWAs would increase CET1 capital requirements by 19 percent for holding companies in Categories I and II, six percent for domestic

⁶ Since 2020, the two other GSIBs that function as custodial banks have not been constrained by the eSLR. This is because Section 402 of the Economic Growth, Regulatory Relief, and Consumer Protection Act permitted these banks to exclude deposits held at central banks from their eSLR calculation. The leverage ratio was not binding for WFC given the impact of the cap on asset size.

⁷ It is important to note, however, that because the tier one leverage ratio was enshrined by section 171 of the Dodd-Frank Act, legislation could be required to make significant changes to this requirement.

holding companies in Categories III and IV, and 14 percent for intermediate holding companies of foreign banks in Categories III and IV. According to a recent [article](#), the Fed and other regulators are now moving towards a plan that would reduce the originally proposed capital increases by about half. However, based on the article, there seems to be disagreement between the Federal Reserve and the other two banking regulators (FDIC and OCC) regarding certain provisions in the proposed capital rules for large banks, specifically related to market risk. In addition, it is unclear how the finalization of the Federal Reserve's proposed changes to its GSIB surcharge framework, for which the SLR measure of total leverage exposure is a direct input, could affect that additional buffer on the risk-based requirements.⁸

The significant uncertainty surrounding the overall effect of the proposal on banks' capital requirements and how they will adjust their balance sheets in response to the finalized changes strongly suggests that leverage ratios will likely bind frequently for the same set of banks included in Figure 2. Furthermore, the level of risk-based requirements for these banks also fluctuates materially due to the excessive volatility in the year-over-year changes in their stress test results and the corresponding buffer.

For these reasons, it is crucial for the agencies to release a proposal with possible adjustments to leverage ratios to ensure that they remain as backstops to risk-based requirements. By doing so, the agencies can provide clarity and maintain the intended role of leverage ratios within the overall capital framework. If they fail to do so, banks will likely continue to be reluctant to make longer-term commitments of their balance sheets to relatively low-risk business lines, such as Treasury market intermediation.

Potential Adjustments to Leverage Requirements

Regulators have several options available to address the issues related to leverage ratios, particularly the SLR and the eSLR. The primary goal of these adjustments is to restore the leverage ratios to their intended role as backstop requirements and mitigate the negative impact of a binding leverage requirement on banks' operations and the broader financial system.

In particular, "fixing" the SLR should remove disincentives to providing liquidity to the Treasury markets. Banks provide liquidity in two basic ways: (1) by buying Treasuries and (2) by providing repo financing (reverse repos) to others who wish to buy Treasuries.

A straightforward option to fix the SLR is to reduce the eSLR buffer by half, from 2 percent to 1 percent, while maintaining the existing 3 percent SLR minimum requirement. This simple adjustment would be applied fairly across all banks subject to eSLR requirements, helping to restore the backstop nature of the leverage ratios. Alternatively, setting the eSLR buffer equal to one-half of the Method 1 capital surcharge for U.S. GSIBs also works as a simple, straightforward and fairly applied solution.

Another approach is to exclude certain assets from the SLR denominator, such as reserve balances, U.S. Treasury securities, and all reverse repurchase agreements that finance U.S. Treasuries. Excluding reserve balances—as currently permitted for custody banks—would reduce the procyclicality in the SLR requirement, as the Federal Reserve tends to increase reserve balances during challenging economic

⁸ Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15), 88 Fed. Reg. 60385 (Sept. 1, 2023).

times. This exclusion would also improve the effectiveness of the SLR as a safeguard against errors in risk weight calibration, given that the correct risk weight for reserve balances is undeniably zero.

Another step would be to exclude U.S. Treasuries held in trading accounts. The rationale for excluding Treasuries in trading accounts is that, unlike Treasuries in investment account, they are subject to risk-based requirements, so there is no need for leverage-based backstops. Finally, it would be also useful to exclude Treasury reverse repos from the SLR. The rationale for excluding those is that the only risk is counterparty credit risk, which already is captured by a separate component of the SLR.

Regulators also need to make similar adjustments to the Tier 1 leverage ratio, with the exception of removing Treasury reverse repos. In contrast to the SLR, the Tier 1 leverage ratio does not have a separate component for counterparty credit risk.

It is equally important to consider corresponding changes at the insured depository institution (IDI) level, given the higher calibration of the IDI-level eSLR and its potential impact on bank lending. As banks are the primary deposit-taking entities within U.S. banking organizations, the expansion of the Federal Reserve's balance sheet has a significant impact on the balance sheets of bank subsidiaries. If IDI-level leverage ratios are not adjusted to account for the increase in reserve balances, BHCs may need to increase the Tier 1 capital of their bank subsidiaries, potentially leading to increased double leverage. Double leverage occurs when a BHC issues debt to fund investments in the equity of its subsidiaries, including its bank subsidiaries. During times of stress, when the bank subsidiary experiences losses, double leverage can make it more challenging for the BHC to service its debt or raise additional capital.

Final Thoughts

In conclusion, leverage ratios have become increasingly binding constraints for the largest U.S. banks, deviating from their intended role as backstops to risk-based capital requirements. This shift has been driven by the growth of safe assets, such as U.S. Treasury securities and reserves, outpacing the growth of banks' intermediation capacity. Using regulatory FR Y-9C data for the eight U.S. GSIBs over the last 10 years, Figure 3 shows that while U.S. Treasuries as a percentage of balance sheet assets have nearly quadrupled, their share of trading assets has decreased by half over the same period.

	Aggregate		
	1Q24	1Q14	Δ
UST % of Assets	11%	3%	7%
Trading Assets % of Assets*	6%	12%	-6%

*Excluding Treasuries

The growth in U.S. Treasury securities has used balance sheet capacity and increased balance sheet costs attributable to the SLR and other post-crisis regulations. As a result, banks have significantly reduced their trading inventories, which serve as a proxy for market intermediation. The binding nature of these leverage ratios—among other regulatory distortions including punitive risk weightings in the

risk-based capital requirements for trading activities—can distort banks’ behavior and potentially impact market liquidity.

As the banking agencies continue to consider changes to the Basel III proposal, it is crucial for them to devote attention to the longstanding issues with leverage ratios and propose necessary adjustments, as previously promised. By doing so, they can restore the intended role of these ratios as backstops and maintain the overall effectiveness of the capital framework while mitigating potential negative impacts on Treasury market intermediation.

The bottom line is that the SLR is problematic for a financial system that features a bloated central bank balance sheet and substantial reliance on market intermediation.

Disclaimer: The views expressed do not necessarily reflect those of the Bank Policy Institute’s member banks, and are not intended to be, and should not be construed as, legal advice of any kind.



Statement for the Record
On Behalf of
Depository Trust & Clearing Corporation | Fixed Income Clearing Corporation
to the
House Financial Services Committee's Task Force on Monetary Policy, Treasury
Market Resilience, and Economic Prosperity

"Examining Treasury Market Fragilities and Preventative Solutions"

Thursday, May 15, 2025

The Depository Trust & Clearing Corporation (DTCC) appreciates the opportunity to provide a Statement for the Record for this hearing, *Examining Treasury Market Fragilities and Preventative Solutions*. DTCC, through its subsidiaries, automates, centralizes, and standardizes the processing of financial transactions, mitigating risk, increasing transparency, and enhancing efficiency for thousands of broker/dealers, custodian banks, and asset managers.

DTCC's Fixed Income Clearing Corporation (FICC) subsidiary has served the Treasury market since voluntary central clearing first started in 1986 and has consistently introduced new innovations that have delivered increased value to market participants. FICC's multilateral netting capabilities offer significant settlement efficiency benefits and can alleviate constraints on Members by reducing the amount of capital required via balance sheet netting. FICC currently processes an average of almost \$10 trillion a day in Treasury activity (as of April 2025). During heightened market volatility last month, FICC processed over \$11.4 trillion in daily activity on April 9, 2025, setting a new one-day volume record. This accomplishment reaffirms the strength of the central clearing model in safeguarding the integrity of the Treasury market. It also highlights the essential value that FICC provides as critical infrastructure, mitigating risk and reinforcing confidence across the financial markets.

For over four decades, FICC has demonstrated resilience to market shocks, ensuring seamless post-trade processing and market stability. We continue to meet stringent regulatory requirements, consistently review and strengthen our risk management capabilities and remain innovative in the development of capital and liquidity efficient solutions to ensure the smooth functioning of the markets.

Thank you for the opportunity to provide this statement and we look forward to working with the Committee and other policymakers on this important topic.



Statement for the Record
James Tabacchi, Chairman¹
Independent Dealer and Trader Association

House Committee on Financial Services
Task Force on Monetary Policy, Treasury Market Resilience and Economic Prosperity

Hearing: Examining Treasury Market Fragilities and Preventative Solutions
Thursday, May 15, 2025, 10:00 a.m.

The Independent Dealer and Trader Association (“IDTA”) appreciates this opportunity to submit this statement for the hearing record on Treasury market fragilities and preventative solutions.

Recent Market Liquidity/Demand

The IDTA believes that liquidity and demand continue to be key risks representing fragilities of the Treasury market, especially in the overnight repo market. The Standing Repo Facility (“SRF”) established through the Federal Reserve Bank of New York (“FRBNY”) in 2021, was designed to address this liquidity risk, and to serve as a backstop source of funding for counterparties in, and to mitigate sudden upwards pressure in the overnight interest rates for, repo transactions.² Despite this, the repo market continues to suffer from high periodic stress, especially at fiscal quarter- and year-end. Last September, for example, quarter-end pressures resulted in greater illiquidity, and the Secured Overnight Financing Rate (“SOFR”) experienced abnormal spikes.³ Likewise, the SRF saw \$2.6 billion in lending in a single day—the highest daily total amount since it was launched.⁴

Given the subject matter of today’s hearing, as it relates to the most recent periods of market stress in late April 2025, the reason for that increased volatility has been materially affected by the change in who buys and now owns Treasury securities. In the past, there was a larger contingent of foreign government and sovereign bond funds. As those buyers have stopped or slowed their buying of Treasuries, professional trading firms and hedge funds have picked up the

¹ Mr. Tabacchi is the chairman of the IDTA and the President & Chief Executive Officer of South Street Securities.
² *The Fed’s Latest Tool: A Standing Repo Facility*, FEDERAL RESERVE BANK OF NEW YORK (Jan. 13, 2022), <https://libertystreeteconomics.newyorkfed.org/2022/01/the-feds-latest-tool-a-standing-repo-facility/>.

³ Davide Barbuscia & Gertrude Chavez-Dreyfuss, *Key US short-term rate surges amid month-end turbulence*, REUTERS (Oct. 1, 2024), <https://www.reuters.com/markets/rates-bonds/key-us-short-term-rate-surges-amid-month-end-turbulence-2024-10-01/>.

⁴ *Id.*

slack. Professional trading firms are distinct in their trading patterns in volatile markets and are traditionally less patient in adding to or even holding an existing position while the market falls.

Needed Modification to the FRBNY Standing Repo Facility Program

Repo rates generally increase at quarter- and year-end, but the September spike was high enough to remind certain industry watchers of the 2019 repo event.⁵ Indeed, market participants had previously predicted that the repo market might suffer severe liquidity issues in 2024,⁶ as the IDTA had pointed out in a prior statement for the record.⁷ While the SRF has provided much-needed liquidity to the repo markets during periods of volatility, and market participants' usage of the facility will only increase, *concentration risk* threatens to undermine the function of the SRF in preventing liquidity crises. As such, the IDTA firmly believes that access to the SRF must be opened to a broader segment of the market as a preventative solution.

The SRF program was initially open only to Primary Dealers,⁸ and access was later extended to depository institution SRF counterparties (e.g., banks). However, non-bank broker dealers that are not Primary Dealers were never granted and continue to lack access to the SRF.⁹ Ironically, it is the larger depository institutions who are exactly those counterparties *least* likely to increase liquidity at fiscal quarter- and year- ends - precisely at the time when the repo market is most in need of liquidity. Relying on these constrained counterparties may therefore limit the necessarily flow of funds during periods of high stress. This represents a concentration risk that exacerbates the liquidity risks that continue to trouble the repo market.

Non-bank independent broker dealers are not as constrained by balance sheet considerations during these periods of stress that the larger depository institution counterparties experience. Independent broker dealers are both willing and able to provide liquidity in these scenarios and can help prevent bottlenecks in funding in the repo market, such as those that occurred in September 2024, September 2019, and October 2015.

Nevertheless, they are denied access to a key source of liquidity because they are neither primary dealers nor affiliated with a bank, a limitation imposed at the time by the FRBNY which only serves to increase liquidity risks in the repo market. This is contrary to the purpose of the SRF, which is precisely to prevent such bottlenecks. While the repo markets stabilized after these previous liquidity events, they will only continue to occur in the future, and broader access to the SRF will better mitigate upward pressures on the repo overnight rates and prevent liquidity crises.

⁵ Robin Wigglesworth, *Is a repeat of the 2019 repo crisis brewing?*, FINANCIAL TIMES (Oct. 10, 2024), <https://www.ft.com/content/b7597b71-8764-4093-bf0f-b6df6ad3c307>.

⁶ Paritosh Bansal, *In the Market: Repo market may throw a fit, spur Fed to action*, REUTERS (Jan. 22, 2024), <https://www.reuters.com/markets/us/market-repo-market-may-throw-fit-spur-fed-action-2024-01-22/>.

⁷ *Statement for the Record for House Fin. Serv. Committee Hearing Titled "Lender of Last Resort: Issues with the Fed Discount Window and Emergency Lending"*, INDEP. DEALER & TRADER ASS'N (Feb. 15, 2024).

⁸ Jonnelle Marte, *Fed establishes standing repo facilities to support money markets*, REUTERS (July 28, 2021, 5:48 PM), <https://www.reuters.com/article/us-usa-fed-standing-repo/fed-establishes-standing-repo-facilities-to-support-money-markets-idUSKBN2EY2OS/>.

⁹ *FAQs: Standing Repo Facility*, FEDERAL RESERVE BANK OF NEW YORK (Dec. 18, 2024), <https://www.newyorkfed.org/markets/repo-agreement-ops-faq>.

The IDTA therefore has recommended to the FRBNY, the Federal Reserve Board of Governors, US Treasury and most recently the Securities and Exchange Commission that access to the SRF should be given to all Tier 1 netting members of the Fixed Income Clearing Corporation (“FICC”), especially non-bank registered broker dealers, and to FICC itself. The IDTA has advocated for this position since the inception of the SRF and has previously made this recommendation in its 2023 white paper (attached) on the Treasury market clearing mandate reforms.¹⁰ This echoes a similar recommendation made by the Group of 30 (“G30”) in a 2021 publication.¹¹

In the G30 publication, which was published prior to the establishment of the SRF, the G30 recommended the establishment of the SRF; however, they proposed that the SRF should “guarantee to a *broad range of market participants* the availability of repo financing for Treasury securities.”¹² In fact, the G30 also pointed out that while, in theory, “banks and primary dealers can obtain liquidity from the Fed and on-lend it to others . . . in a crisis the willingness of those firms to intermediate has tended to be constrained by a combination of regulations and internal limits on the firms’ risk-taking, *both of which have tended to tighten under stress.*”¹³ But the fact that the ultimate source of liquidity in such times is the FRBNY, which would be fully collateralized by US Treasuries and repriced daily, makes such transactions virtually riskless.

The Need for More Primary Dealers of US Government Securities

The IDTA also recommends, as it has in its above-mentioned white paper, that the U.S. Treasury and FRBNY should expand the primary dealer program to include more non-bank registered broker dealers. This measure would also decrease the concentration risk in relying only on large depository institutions to implement monetary policy and ensure that a broader range of diverse and *competitive* participants are ready to maintain more consistent and deeper liquidity.

In conclusion, the IDTA reiterates that the SRF has been a valuable tool in addressing liquidity risk in the repo market. However, the narrow access model has resulted in concentration risk that threatens the efficacy of the SRF in addressing liquidity risks. As such, the IDTA proposes that access to the SRF should be broadened to all Tier 1 netting members of FICC and to FICC itself, and that there should be more primary dealers that are non-bank registered broker dealers. These commonsense proposals directly address the SRF’s concentration risk and would help to prevent liquidity bottlenecks and to mitigate upward pressure on the overnight repo rates.

Thank you for your attention to this matter.

¹⁰ See INDEP. DEALER AND TRADER ASS’N, AFTER COVID-19, A BANKING CRISIS, AND THE UNCERTAINTY OF RAISING THE DEBT CEILING: HOW TO EXPAND THE SEC’S PROPOSED TREASURY AND REPO MARKET CENTRAL CLEARING MANDATE TO ENABLE BROADER REFORMS FOR GREATER TREASURY MARKET FINANCIAL STABILITY (June 2023), available at <https://blog.idtassoc.com/june-29-2023>.

¹¹ GROUP OF THIRTY, U.S. TREASURY MARKETS: STEPS TOWARD INCREASED RESILIENCE, (July 2021), available at https://group30.org/images/uploads/publications/G30_U.S._Treasury_Markets-Steps_Toward_Increased_Resilience_1.pdf.

¹² *Id.* at 7 (emphasis added).

¹³ *Id.* (emphasis added).

Ranking Member Waters:

1. Which of the following options best describes your self-identified race? (You may choose more than one.)
 - a. White or Caucasian
 - b. Black or African American
 - c. Hispanic/Latinx
 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity?
 - a. Woman
 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

FRENCH HILL, AR
CHAIRMAN



MAXINE WATERS, CA
RANKING MEMBER

United States House of Representatives
One Hundred Nineteenth Congress
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Questions for the Record
The Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity
of the Committee on Financial Services
Hearing, entitled: “Examining Treasury Market Fragilities and Preventative Solutions.”
May 15, 2025

Ranking Member Waters:

Dr. Darrell Duffie, Ph.D.,

1. Which of the following options best describes your self-identified race? (You may choose more than one.)
 - a. White or Caucasian
 - b. Black or African American
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 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

2. Which of the following options best describes your gender identity?
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 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
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Ranking Member Waters:

Mr. Ira Jersey,

1. Which of the following options best describes your self-identified race? (You may choose more than one.)
 - a. White or Caucasian
 - b. Black or African American
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 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

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 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

Questions for the Record

**Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity
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May 15, 2025

Representative De La Cruz:

Question: Mr. Wuerffel, I recently introduced a bill called the “Bringing the Discount Window into the 21st Century Act,” which would require the Federal Reserve to conduct a review of the discount window, a key source of liquidity that small banks rely on in times of stress.

1. How do we de-stigmatize the discount window?

BNY supports faster, more reliable, and more efficient ways to exchange Treasury securities for cash. A more liquid market can help avoid market dysfunction by giving market participants the ability to easily convert their Treasury holdings to cash, making the need for large-scale central bank intervention more remote. As I stated in my testimony, one solution to improve market liquidity includes expanding the readiness and lowering the stigma to use the discount window so that it can be tapped readily. Some policies that have been proposed include incorporating discount window borrowing capacity into liquidity requirements, reforming the existing public disclosure requirement, adjusting supervisory expectations around usage, and improving the efficacy of discount window operations through automation.

2. My bill calls for a public comment period. What are possible suggestions you would have to improve discount window performance?

BNY supports policymakers’ efforts to enhance the discount window and has assisted liquidity providers and market participants in the timely provision of liquidity through its triparty platform. Improving the mobility of collateral across public and private sector sources of liquidity, including the discount window, could help enhance the ability of banks to access liquidity more easily. We acknowledge the work the Federal Reserve has already undertaken to advance functionality of the discount window and support further modernizing operational processes, as well as expanding banks’ readiness to borrow. Similarly, the Federal Reserve Board [requested](#) information in September 2024 on operational aspects of the discount window and intraday credit. These comments should be considered to help inform potential legislative solutions.